EXPORT CANADA

Opportunities and Challenges in the World Economy

CANADIAN FOUNDATION FOR ECONOMIC EDUCATION

CFEE

LA FONDATION CANADIENNE D'EDUCATION ECONOMIQUE

by Gary Rabbior

EXPORT CANADA: OPPORTUNITIES AND CHALLENGES IN THE WORLD ECONOMY

An introduction to trade, our ability to trade and major trade issues and questions which confront Canada.

by Gary Rabbior

Illustrations by

CANADIAN FOUNDATION FOR ECONOMIC EDUCATION

Recognizing the importance of trade to the Canadian economy and the need for export education, the Canadian Foundation for Economic Education (CFEE) developed a proposal for a study-guide for use in secondary schools and by the general public. This proposal was submitted to the Department of External Affairs which is responsible for Canadian international trade and the Department agreed to provide financial support for the project.

Throughout the project, the Canadian Foundation for Economic Education benefitted from the advice of officials of the Department of External Affairs and other individuals and organizations (as noted in the acknowledgements), including provincial trade and education authorities.

On behalf of all those involved in this project, we would like to express our hope that the publication represents a significant contribution toward export education and the understanding of the importance of export trade to Canada.

Gary Rabbior
Executive Director
Canadian Foundation for Economic Education

EXPORTS BUILD CANADA
EXPORTER, ÇA RAPPORTE

The Canadian Foundation for Economic Education (CFEE) wishes to acknowledge with gratitude those who have given their permission to use copyrighted material in this publication.

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ACKNOWLEDGEMENTS

On behalf of the Canadian Foundation for Economic Education (CFEE), I wish to extend appreciation to the following persons and organizations for their assistance in the preparation of this publication:

- Canada. Department of External Affairs

  Robert Latimer
  Assistant Deputy Minister,
  Economic and Trade Policy Branch

  Ken Sunquist
  Director, Canada Export Trade Month

- Provincial Government Trade Representatives

- Provincial Government Education Representatives

- Content Advisors to the Project

  Charles Barrett
  Vice President and Director,
  International Business Research Centre,
  The Conference Board of Canada

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  Vice President and Director,
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  and Chairman of the Board, CFEE

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  Northern Telecom

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  Gary O'Meara
  St. George's College, Toronto, Ontario

  Sylvia Post
  Madawaska Valley District High School,
  Barry's Bay, Ontario

  Manford Wasson
  Miramichi Valley High School,
  Newcastle, New Brunswick

- James D. Thexton, Professor, Faculty of Education, University of Toronto, for his work on the accompanying *Teacher's Guide*

- Peter Pickersgill, cartoonist, for his creative illustrations

- Ted R. Krawec, for research and general assistance throughout the project

- Libby Joyce, economist, for editing the manuscript

- The editorial, production, and clerical staff of CFEE for their diligent efforts.

G. R.

PREFACE

This publication has been prepared with the objective of building an increased understanding among Canadians of the importance of international trade and trade issues to the Canadian economy. Canada's opportunities for economic growth are directly linked to our export trade potential. Hence, the economic well-being of Canadians is linked significantly to our success in competitive global markets. The Canadian Foundation for Economic Education (CFEE) strongly believes that a broader understanding of the crucial trade questions and issues, leading to informed discussion and debate, is important in this time of rapid global change.

Toward this end, **EXPORT CANADA** has been designed primarily as an instructional aid for Canadian teachers and students, to provide a tool with which to help young Canadians confront the responsibilities and challenges which they inevitably will face. The publication aims to support secondary school teachers in those curriculum areas which integrate, or may be expanded to include, the study of international trade. Thus, the educational edition, containing an insert entitled *A Companion Reading for Students*, develops a high school scenario which is analogous to an international trade situation. In addition, a Teacher's Guide has been developed and is available upon request from CFEE. (Please note that *A Companion Reading for Students* does not appear in the general edition.)

Although **EXPORT CANADA** was written at a level which is appropriate for high school students, it is hoped that it will also circulate widely and be referred to often by every interested Canadian. Canada's future as a properous democratic society depends on an informed citizenry having an understanding of how our economy works. The international economic and social issues highlighted here should be of importance to all Canadians.

International economic issues and Canada's role in the international trading environment are wide-ranging subjects. It is recognized that a document of this size cannot explore in depth all the factors involved in such a complex area. Nevertheless, if these key fundamental facts, coupled with a series of issues and questions, encourage the reader to pursue further knowledge of the subject through discussion and investigation of the issues, then this publication will have achieved its objective.

The development of **EXPORT CANADA** has greatly benefited from the comments of numerous persons who willingly gave of their time and individual expertise. Educators, representatives of business, labour and government, and others whose perspectives and suggestions have helped balance the content of this publication, deserve our whole-hearted thanks and CFEE is very appreciative of their help.

INTRODUCTION

Canada has never been a nation to walk away from a challenge. At this moment, the world is issuing a challenge to Canada — one that Canadians must face or risk serious consequences. The testing ground won't be a battlefield or a hockey rink. It will be the international trading markets around the world.

> *Our country has a high international reputation. Canada has taken initiatives for better international understanding — notably since World War II. But even before that. We have a cosmopolitan population, drawn from all the major racial strains on the face of the planet. Yet individual Canadians still tend, too often, to look inward, to their own narrow community of group or region. We cannot afford to do that anymore. We live in the global village. It's here. It's now. It's time we got to know our neighbours in it and established fruitful exchange with them.*[1]
>
> — Camille A. Dagenais, Chairman, The SNC Group

Canada sells 30% of its total output (goods and services) to other countries. (It is interesting to note that if we consider only goods, and not services, Canada exports close to 50% of the goods it produces.) This creates jobs and brings money into our country. Canadians are better off because of our ability to sell what we produce in international markets.

But the conditions of the international trading game are changing. Countries of the Pacific Rim are developing. Japan, Singapore, Hong Kong and South Korea are standing up to us as formidable competitors in international markets. Third World countries are selling resources that compete with ours. The European Economic Community is trading more within itself and less with other countries in the world. Lower production costs for some products in South American and other countries are giving these countries an advantage over Canada. Countries like the U.S. and Japan are making rapid technological advances. They are producing new products and making other products better, faster or cheaper.

The call is out and we, as Canadians, have to decide how we are going to meet the challenge. If we want to maintain our standard of living, we have to maintain our ability to trade. If we want to improve it, one way is to expand our export trade. But the world is changing rapidly. We must adapt and develop as quickly as other countries.

The techniques we'll use to weather these rapid changes have yet to be agreed upon. But there is almost total agreement on one vital ingredient — we must develop a national consensus, a national commitment to face this challenge.

It is not something that will be left to a small group of Canadians. It will involve virtually all of us — our creativity, our efforts, our skills.

The aim of this publication is to make a contribution toward the increased understanding by Canadians of international trade and trade issues. A national will, commitment or consensus will not develop in a nation of people who do not fully understand the conditions about which they must make crucial decisions. We face issues and decisions such as:

- do we continue to rely heavily on our primary industries for employment and trade? If not, how do we shift resources to other production areas?
- how do we compete more effectively in manufacturing and other high technology industries?
- how do we increase our productivity to achieve more with the same resources?
- do we continue to concentrate on trade with the U.S. or do we look at other areas, such as the Pacific Rim, more extensively?
- do we continue to protect certain industries (such as clothing and shoe production) in Canada through tariffs on foreign competitors' goods and services entering Canada?
- do we use tax dollars to rebuild companies which are struggling or failing? Instead, do we divert that money to firms which are already competitive with opportunities to grow? Or should the emphasis be on providing funds to new projects? Should the market, rather than government, pick winners and losers?
- how can we encourage technological development in Canada?
- how can we effectively address the variations in regional perspectives on trade in Canada? How are the continually changing domestic and international concerns of the regions taken into consideration in establishing trade policy?
- how do we help the people adjust whose jobs disappear as a result of technological change?

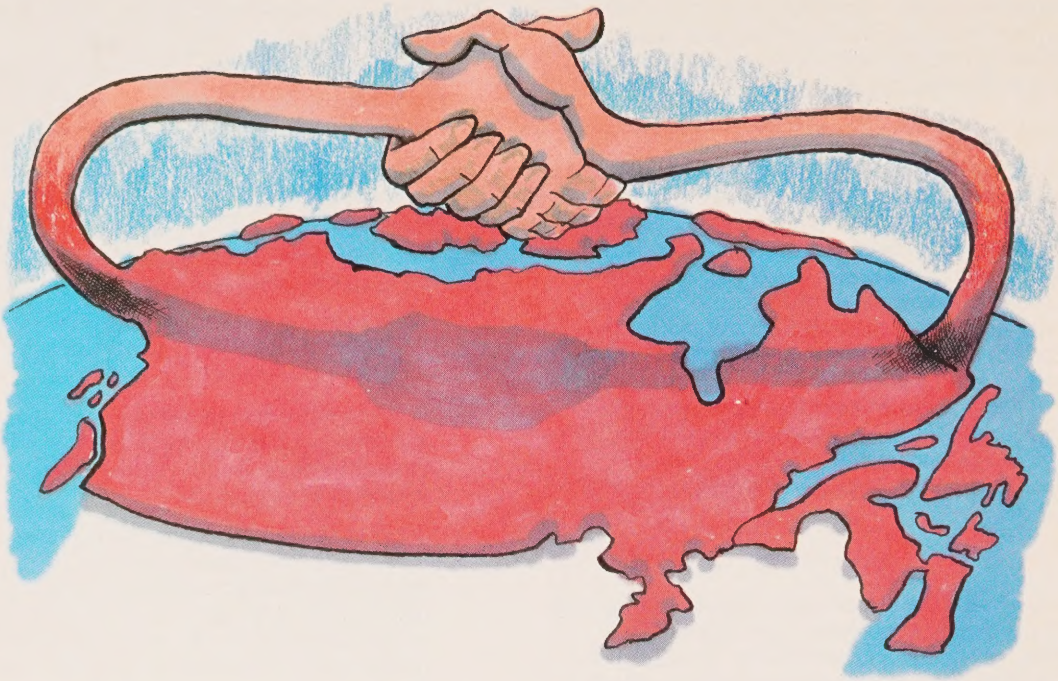
The list of important questions about our international position could go on. It is our hope that after reading this publication you will feel more confident in searching for answers to the questions.

Our aim is not to provide answers here. It is to make you familiar with the questions and the issues. Throughout the publication there are "Tell Us What you Think" challenges. We invite you, either individually or as a group or class, to write to the Canadian Foundation for Economic Education with your opinions on these issues. We will collect your thoughts and forward them to government, business, labour and consumer organizations so that these groups know where you stand.

Active discussion and debate is crucial if we are to develop a national consensus. Our international success will be determined as much by our attitudes as it is by what we do in our daily work.

Richard Gwyn, columnist with The Toronto Star, expressed this feeling well when he wrote:

> *"What we lack, conspicuously, is an economic consensus, not so much about the need to become internationally competitive as about how it can be achieved. . .*



Our trade success will be helped by co-operation and consensus

"Indeed, the solution to our economic problems may not be economic. It may reside instead in entrepreneurship, in a recognition that what will make the difference won't be a plan on paper but what goes on inside our heads . . .

*"The only change that matters will be in our heads. We have to decide whether to commit ourselves to become internationally competitive. But we also have to do this in a way that preserves the best in our society, since the preservation of that society . . . is the end, and international competitiveness merely is a means toward that end."**

To meet the future challenges of international competition will require changes in Canada. These changes will in some cases be difficult. People's lives and livelihoods may be affected. Therefore, it is all the more important that, as a nation, we understand the conditions and issues we face. A great deal will depend on our making effective decisions and choices.

It is our hope that through this publication, we can assist Canadians in developing confidence in their decisions. At the very least, we hope to raise the issues and highlight the challenges. At best, we would hope this booklet contributes to the development of a consensus among Canadians concerning trade objectives and commitment to the means to achieve our goals.

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*Extract from "We must learn to hustle in new world economy" by Richard Gwyn. **The Toronto Star**, May 9, 1984.

CHAPTER I

AN INTRODUCTION TO TRADE

A key ingredient in economic success for a country is the ability to export. This is particularly true for Canada. We have a relatively small population — something for which we are usually thankful. But a small population in a country has only so much money to spend. We have vast quantities of resources, factories, a well-educated labour force, creativity and talents. But our citizens have limits to their spending on the goods we produce.

By selling what we produce to other countries, we bring money and wealth to Canada. This can help us in our efforts to improve our standard of living.

Furthermore, there are many items from other countries that Canadians would like to have. As a nation, we don't produce all of the goods and services we seek to purchase. We import.

Where do the different currencies come from needed to pay for **imports**? One major source is our **exports**. The money we bring into Canada through sale of our exports, provides incomes with which we are able to purchase import items we want. To import we need to export.

In Canada, we have tended to concentrate on selling our natural resources to other countries. This enables us to buy other things — other things either from Canadians or other countries. Natural resources have been an area in which we have tended to ''specialize''. Do we continue to specialize in our resource production? First, let's look more closely at what is meant by **specialization**.

■ SPECIALIZATION

To understand the importance of specialization we ask you to think back — way back — to the early dawn of man and woman. In those early days, families fended for themselves finding a cave for a home. They made their own clothes and obtained their own food. An independent life, yes, but not one with a very high standard of living.

Evolution shows that a significant development took place. Independence was fine but it was difficult. It was apparent that some people were better at certain tasks than others. The standard of living could be improved if larger groups came together and people concentrated on what they did best — hunting, fishing, growing crops, making clothes, cooking, house building. Homes could be built faster and better. More food could be obtained. More clothes could be produced. Mankind, for the most part, gave up economic independence and became **interdependent**. To a limited degree, people specialized in certain activities.

Specialization is very prominent in today's world. As you read this, you are probably involved in a process to develop a specialized talent (or you will have already done so). You may be working to become a scientist, engineer, gardener, pilot, mechanic, chef or accountant. There are thousands of specialized occupations which you might pursue.

Specialization leads to greater interdependence and a higher standard of living

Each of us tends to concentrate in an area of specialty. We earn an income from that talent and expertise. Then we use that income to acquire things which are produced by other people.

In the early economic days people used to trade (or **barter**) what they produced for what others produced — meat for clothes — furs for seed. This was a very cumbersome process. Specialization meant trading was necessary. But to barter one item for another became more and more complicated as more was produced.

Hence came the creation of **money** — a medium of exchange. Money was something to simplify the process of trading. Everything was evaluated in terms of money. Rather than having to figure out how many pairs of shoes a new mule was worth, the shoemaker sold shoes for money. That money was then used to pay for the mule. A mule then had one price in terms of money rather than hundreds of prices in terms of products or services.

Specialization was a major economic development. It meant an improvement in the standard of living. It made people interdependent rather than independent. And it led to the creation of money to simplify the process of exchange. Some people may not find specialization as interesting or fulfilling as "doing-it-all-yourself", but we have much to appreciate in terms of our gains from specialization.

Specialization can apply to more than individuals. In the same way that individuals can specialize and trade and become better off, countries can too. Countries can specialize in producing certain goods/services and trade them with other countries. In this way a country can earn income to buy things which it does not produce. The more a country can sell outside its borders, the more income comes into the country. The country becomes better off — wealthier — and its people can obtain a higher standard of living.

Canada is very much involved in trade. Our ability to trade is a key factor affecting our standard of living in Canada. Our ability to trade and sell what we produce is dependent on some very important decisions. One of those key decisions is — in what do we specialize? In economics, there is a theoretical way to determine what a country should produce for export. It's determined by a country's **comparative advantage**.

■ ABSOLUTE AND COMPARATIVE ADVANTAGE

Consider the two countries of Canada and Guatemala. Canada has excellent farmland for growing wheat. Guatemala, on the other hand, has excellent conditions for producing coffee. Both countries can produce both crops although obviously each will have an area of advantage over the other.

Consider, further, the following hypothetical example. Assume 1 unit of resources (i.e. 1 unit of land, labour and **capital**) can produce 10 kilograms of wheat or 2 kilograms of coffee in Canada. Assume the same unit of resources in Guatemala can produce 2 kilograms of wheat or 10 kilograms of coffee. That is,

Chart A

Using 1 unit of resources the following can be produced in each country.

	Wheat		Coffee
Canada	10 kg	or	2 kg
Guatemala	2 kg	or	10 kg
Total Output	12 kg		12 kg

Therefore Canada can produce 10 kg of wheat for every 2 kg of coffee. That reduces down to 5 kg of wheat for every 1 kg of coffee. Using the same resources, Canada can produce 5 times as much wheat as coffee. Canada is obviously much better at producing wheat than it is at producing coffee.

Guatemala, on the other hand, can produce 10 kg of coffee for every 2 kg of wheat or 5 kg of coffee for every 1 kg of wheat. Guatemala is, therefore, better at producing coffee than wheat.

One unit of resources can produce 10 kg of wheat in Canada or 2 kg of wheat in Guatemala. Canada is obviously better at producing wheat than Guatemala. Canada is said to have an **absolute advantage** in the production of wheat. Guatemala, on the other hand, has an absolute advantage in the production of coffee.

By specializing, the two countries can increase the total amount of coffee and wheat produced and then trade. The following shows how both countries can be better off by specializing in one area of production.

Suppose, rather than 1, each country has 10 units of resources. Suppose each uses 5 units to produce coffee and 5 to produce wheat.

Chart B

	5 units of resources to produce **Wheat**	5 units of resources to produce **Coffee**
Canada	10 kg × 5 = 50 kg	2 kg × 5 = 10 kg
Guatemala	2 kg × 5 = 10 kg	10 kg × 5 = 50 kg
Total Output	60 kg	60 kg

Now suppose Canada decided to specialize in wheat and Guatemala in coffee. (N.B.: Specialization doesn't necessarily mean that a country produces all of one thing and none of another. It can mean that a country will tend to concentrate more on a certain type of production.) Each switches three units of resources to its area of specialization — Canada switches 3 to wheat and Guatemala 3 to coffee.

Chart C

	Wheat	**Coffee**
Canada —8 units for wheat —2 units for coffee	10 kg × 8 = 80 kg	2 kg × 2 = 4 kg
Guatemala —2 units for wheat —8 units for coffee	2 kg × 2 = 4 kg	10 kg × 8 = 80 kg
Total Output	84 kg	84 kg

Note that more of each product will be produced through specialization (84 kg of each rather than 60 kg). This means that both countries, with more of each good produced, can become better off. They can specialize, produce more and trade. Note, however, that the two countries will *have* to trade for specialization to make them better off.

Specialization, and trade, benefits countries by enabling more production and generating more income. It also benefits the world economy because it results in more production and can help to lower prices.

For Canada, the key decision is where to specialize. It is important for Canada to consider the areas in which it has an absolute advantage over other countries. But there's more — and that brings us to the point raised earlier — that of comparative advantage.

Consider the following example. Suppose with 1 unit of resources the U.S. can produce 10 tonnes of soybeans or 1 kg of wheat. Similarly with 1 unit of resources Canada can produce 15 tonnes of soybeans or 3 kg of wheat.

Chart D

	Soybeans		**Wheat**
U.S. — 1 unit of resources produces	10 t	or	1 kg
Canada — 1 unit of resources produces	15 t	or	3 kg
Total Output	25 t		4 kg

From the previous discussion it is obvious that Canada would have an absolute advantage in both areas of production. Using 1 unit of resources it can produce both more soybeans or wheat. This might imply that Canada should specialize in both and the U.S. in neither. It might also lead one to ask — how could Canada benefit from trade with the U.S. if it has an absolute advantage in producing both products?

The key to the answer is comparative advantage. The theory of comparative advantage was initially developed by the British economist David Ricardo back in the early 1800s. His theory illustrated that two countries can benefit from trade (even if one country is better than the other at producing all items) if each country specializes in its area of comparative advantage.

Comparative advantage simply means that one country can produce a good or service *relatively* more cheaply than the other. Let's consider this in our example.

With one unit of resources the U.S. can produce 1 kg of wheat or 10 t of soybeans. Therefore, the cost to the U.S. of producing 1 kg of wheat is 10 t of soybeans. (10 t of soybeans is given up — it is the **opportunity cost**.)

Canada, using 1 unit of resources, can produce 15 t of soybeans or 3 kg of wheat. Therefore to produce 1 kg of wheat costs Canada 5 t (15/3) of soybeans.

Therefore, in relative terms, wheat costs less in Canada than in the U.S.

Now consider soybeans. To produce 1 t of soybeans costs the U.S. 1/10 kg of wheat. To produce 1 t of soybeans costs Canada 1/5 kg of wheat.

Therefore, in relative terms, soybeans cost less to produce in the U.S. than in Canada.

These calculations show that Canada has a comparative advantage in wheat because it can produce wheat more cheaply than the U.S. They also show that the U.S. has a comparative advantage in soybeans.

The theory of comparative advantage states that a country should specialize in the production of those goods and services in which it has a comparative advantage. In this case the U.S. should specialize in soybeans and Canada in wheat.

Let's check to verify. Refer back to Chart D. Now assume that Canada and the U.S. both have 10 units of resources. Assume 5 are allocated in each country to each type of production. That would yield the following:

Chart E

	5 units of resources to produce **Soybeans**	5 units of resources to produce **Wheat**
U.S.	10 t × 5 = 50 t	1 kg × 5 = 5 kg
Canada	15 t × 5 = 75 t	3 kg × 5 = 15 kg
Total Output	125 t	20 kg

According to the conclusions reached above, the U.S. should shift resources (specialize) to producing soybeans and Canada should shift resources to producing wheat. The result should be that each country should stand to gain by trading with the other. Let's see.

Assume the U.S. shifts 4 units of resources into the production of soybeans and Canada shifts 2 into the production of wheat. Therefore, the U.S. specializes more than Canada.

The results are shown in Chart F.

Chart F

	Soybeans	**Wheat**
U.S. —9 units for soybeans —1 unit for wheat	10 t × 9 = 90 t	1 kg × 1 = 1 kg
Canada —3 units for soybeans —7 units for wheat	15 t × 3 = 45 t	3 kg × 7 = 21 kg
Total Output	135 t	22 kg

Through specialization more of both products are produced. Soybean production is now 135 t rather than 125 t. Wheat production is now 22 kg rather than 20 kg. Each country should be able to make itself better off by specializing, increasing production and trading with the other.

■ TERMS OF TRADE

But will this happen? Will countries specialize the way the theory says they should? Is it as simple as calculating comparative advantage the way we've done here? Let's see.

It's obvious from the last illustration that through specialization the two countries can produce more of each good in total. The issue becomes whether or not the countries can agree on **terms of trade** that will enable both to gain from trade — and make the process of specialization worthwhile.

The key phrase is terms of trade. Assume that before specialization, Canada was producing just what it needed (that is, it was using 10 units of resources to produce 75 t of soybeans and 15 kg of wheat).

After specialization Canada is producing 45 t of soybeans (with 3 units of resources) and 21 kg of wheat (with 7 units of resources). Will Canada benefit by specializing and trading with the U.S.? That depends. Canada had 75 t of soybeans and 15 kg of wheat. It now has 21 kg of wheat so it has up to 6 kg of wheat that it could trade.

It needs at least 30 t of soybeans to get back to where it started before specialization (was 75 t, is now producing 45 t). Whether Canada would benefit depends on the terms of trade established between Canada and the U.S., that is, the price each country charges for *its* product of specialization expressed in quantities of the *other* country's product.

Suppose the terms of trade worked out to be that 1 kg of wheat traded for 8 t of soybeans. Canada could, therefore, trade 5 kg of wheat to the U.S. and in exchange receive 40 t of soybeans. That would leave Canada with 16 kg of wheat and 85 t of soybeans. This compares with 15 kg of wheat and 75 t of soybeans prior to specialization and trade. Canada would definitely gain from specialization and trade (if the terms of trade were 1 kg of wheat:8 t of soybeans).

What about the U.S.? Before specialization it produced 50 t of soybeans and 5 kg of wheat. After specialization it produced 90 t of soybeans and 1 kg of wheat. If the terms of trade were, as above, 1 kg of wheat:8 t of soybeans, and Canada wanted to trade its 5 kg of wheat, would the U.S. go for the deal? Would it benefit?

Canada offers 5 kg of wheat to the U.S. in return for 40 t of soybeans. The U.S. after the trade would then have 6 kg of wheat (1 it produced and 5 it received in the trade) and 50 t of soybeans (compared with 5 kg of wheat and 50 t of soybeans prior to specialization). Therefore, the U.S. would also end up benefitting by specialization and trade.

In summary, at terms of trade equal to 1 kg of wheat:8 t of soybeans:

Chart G

	Soybeans	**Wheat**
Canada — before specialization and trade	75 t	15 kg
Canada — after specialization and trade	85 t	16 kg
Gains from Trade	+10 t	+1 kg
U.S. — before specialization and trade	50 t	5 kg
U.S. — after specialization and trade	50 t	6 kg
Gains from Trade	0 t	+1 kg

Therefore, the two countries can benefit from specialization and trade. This is true even though one country is better than the other at producing both goods. The key is for each country to specialize in the area in which it has a comparative advantage. That is, each country should produce those goods and services which it can produce for relatively less cost than the others.

But the key determinant of whether trade will occur and how each country will gain from specialization and trade will be the terms of trade.

The trade between Canada and the U.S. described above would appear to benefit Canada more than the U.S. The U.S. may hold out for better terms of trade that would result in a more equitable distribution of the gains from trade. The terms of trade will play the role of determining the extent of trade and how each country will benefit. (Select other terms of trade and determine whether or not trade would take place on those terms, e.g. would the U.S. be willing to trade if Canada demanded 10 t of soybeans for 1 kg of wheat? Why or why not?)

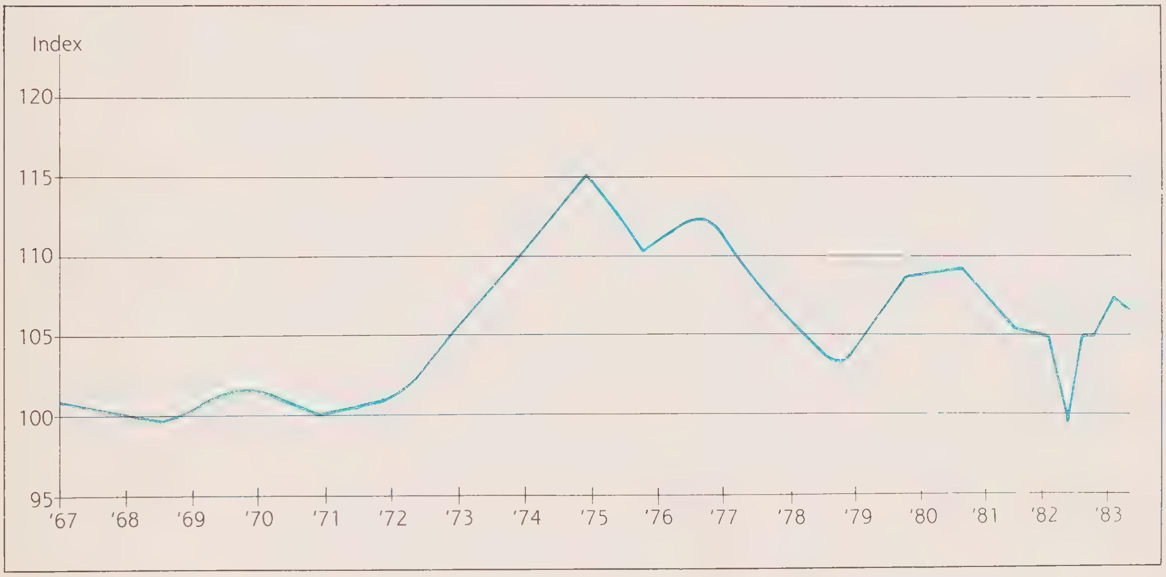
One bit of confusion may arise from looking at trade this way because we do not tend to trade wheat for soybeans directly. Money was created to simplify the process of exchange. Most import and export goods and services are paid for in money, not in other goods and services. Therefore, it is difficult to look at the terms of trade in terms of 1 kg of wheat:8 t of soybeans. (We will take a look at the money side of things shortly.)

Two other factors complicate the issue. First, Canada produces many more than two commodities. Second, Canada trades with countries other than the U.S. Therefore, looking at our simple example of two goods and two countries it is easy to work out the terms of trade and see how each country would benefit. But what about the real world?

In fact, the real world isn't as different from our example as you might think. In the trading Canada does with all of our trading partners, the terms of trade will be determined by the value of the goods we export relative to those we import.

Visual 1

TERMS OF TRADE, 1968-83*
1971 = 100



*Price of merchandise exports divided by price of merchandise imports (1971 = 100) × 100
Source: Statistics Canada: The Conference Board of Canada

Canada. Department of External Affairs. **A Review of Canadian Trade Policy, A Background Document to Canadian Trade Policy for the 1980s.** Ottawa: Supply and Services Canada, 1983; Statistics Canada. **Quarterly Estimates of the Canadian Balance of International Payments.** Quarterly. Catalogue no. 67-001.

Visual 1 shows the general terms of trade for Canada from 1968 to 1983. As a hypothetical example, suppose the average price of Canada's exports was \$4 and the average price of imports was \$2. The terms of trade would be 4/2 × 100 = 200. If the price of exports rose to \$5 and the price of imports stayed the same, that should be better for Canada. The terms of trade would be 5/2 × 100 = 250. Therefore, the higher the terms of trade figure, the more advantage for Canada because it means the price we are receiving for our exports is rising relative to that for our imports.

The Visual shows a good improvement in Canada's terms of trade from around 1972 to 1974. Why might this have happened? Our terms of trade have generally been declining since 1979. What do you think would be the explanation for this?

For example, let's broaden our example. Suppose Canada produces minerals, space arms, snowmobiles, wheat and fish. Suppose further that we import tape players, televisions, automobiles, bananas and coffee. The value of each of these products will be determined by international market forces. If the value of Canada's exports rises in world markets, and the value of imports stays the same, the terms of trade will improve for Canada. More money will come in to Canada than before. The same will go out. So our wealth and gains from trade will increase. The terms of trade for Canada will be determined by whether the world value of our exports is increasing or decreasing relative to the world value of our imports.

We can, at this point, draw two major conclusions:

— A country can gain through specialization in its areas of comparative advantage and trading with other countries.

— The gains to a country from trade will depend on the terms of trade which are established in world markets.

These are two major concepts in the area of international trade. If you have a basic understanding of them, you're a long way down the road. But many issues, questions and decisions confront Canadians. These will be covered a little further on in the text. For now, let's turn our attention to an issue of concern to all Canadians — the value of our money.

N.B. Please note that throughout the discussion of comparative advantage and terms of trade, accuracy of weight equivalents, as used in the hypothetical trade ratios, was sacrificed for simplicity and clarity of explanation.

THE RELATIONSHIP BETWEEN TRADE AND THE VALUE OF THE DOLLAR

To consider all the forces which influence the value of the Canadian dollar in world markets is beyond the scope of this publication. However, it is possible to introduce some aspects of the relationship between our trade position and the value of our money.

Imagine you are travelling to another country — for example, the United States. When planning a trip to the U.S., what money would you take? Most often you would exchange your Canadian dollars for American dollars. You would do this at a **foreign exchange** office, bank or trust company.

The reason for changing your money is acceptability. When you go to the U.S. and pay for a meal at a restaurant or pay to go to an amusement park, the restaurant owner or ticket seller will usually expect to be paid in U.S. currency. The reason is that they don't want to have to go to the trouble of exchanging your Canadian money for American. Exchanging currency takes time and costs money.

Now, you may not realize it, but when you spend your travelling money you are actually buying an import — U.S. tourism. You are spending Canadian money on foreign travel rather than Canadian travel.

In the same way that you would exchange your Canadian money for U.S. money to purchase "U.S. Tourism", exporters of other U.S. products to Canada usually expect to be paid in U.S. currency. Similarly, Canadian exporters usually expect to be paid in Canadian dollars when they sell their goods to another country.

For now, note this as point number one — exporters usually expect to be paid in their own currency.

Point two — throughout the world there are **foreign exchange markets**. In these markets, the currencies of different countries are bought and sold. Because these markets are linked electronically, the price of each currency is more or less uniform around the world.

Point three — in these foreign exchange markets, the value of a country's currency will be largely determined by the market forces of demand and supply. The more of a country's money there is available in these markets (that is, the larger the supply) the lower will tend to be its value. Also, the stronger the demand for a country's currency (the more people are trying to buy it) the higher will be its value. This demand and supply relationship will go a long way to determining the international value of a country's currency.

Point four — it's now time to bring points one, two and three together. To buy Canadian exports, people in other countries have to go to the foreign exchange markets and buy Canadian dollars with their own currency. Selling our exports, therefore, increases the demand for Canadian dollars.

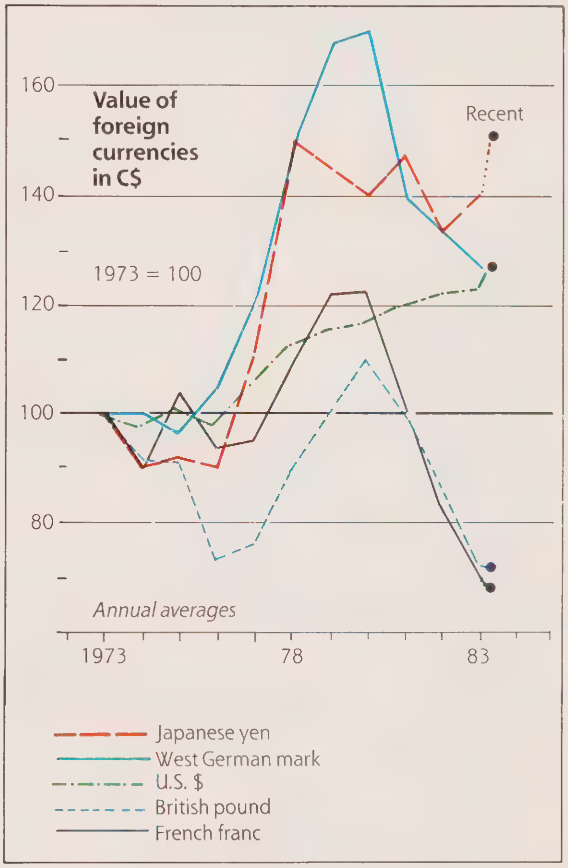
When goods are imported into Canada, Canadian importers have to buy other countries' currencies (in the foreign exchange markets) with Canadian dollars. Importing, therefore, increases the supply of Canadian dollars in the international money markets.

Consider a simplistic example. Suppose no money moves into or out of Canada other than to buy and sell imports and exports. Suppose further that Canada imports considerably more than it exports. What do you think would happen to the international **value of the Canadian dollar**?

Recall that imports increase the supply of Canadian dollars in international markets, and exports increase demand. If we import more than we export, the supply of Canadian dollars in our example will tend to exceed the demand. When supply exceeds demand, there is downward pressure on price. Therefore, the tendency would be for the value (price) of the Canadian dollar to fall.

Visual 2

Exchange rates have a big impact on trade and they've been all over the map in the past 10 years. Generally, a lower C$ makes us more competitive.



"Enormous strides made in trade over a decade." **The Financial Post**, March 31, 1984.

Visual 2 shows the value of other countries' currencies in Canadian dollars from 1973 to 1983. Which currency has tended to be the strongest in terms of our dollar over this 10 year period? Why do you think this was the case? Which became the strongest currency towards the end of the 10 year period? Why? Which countries' currencies have been the weakest? Why? Which country's currency has had the steadiest most continuous climb in value? What impact might there be on our trade with Japan if the value of the yen suddenly declined considerably in terms of its value in Canadian dollars?

Perhaps you have heard on news reports of the Bank of Canada 'stepping in to support the value of the dollar'. To understand this it is important to know that the Bank of Canada has **foreign exchange reserves**. That is, in the event it needs them for some purpose, the Bank holds quantities of other countries' currencies.

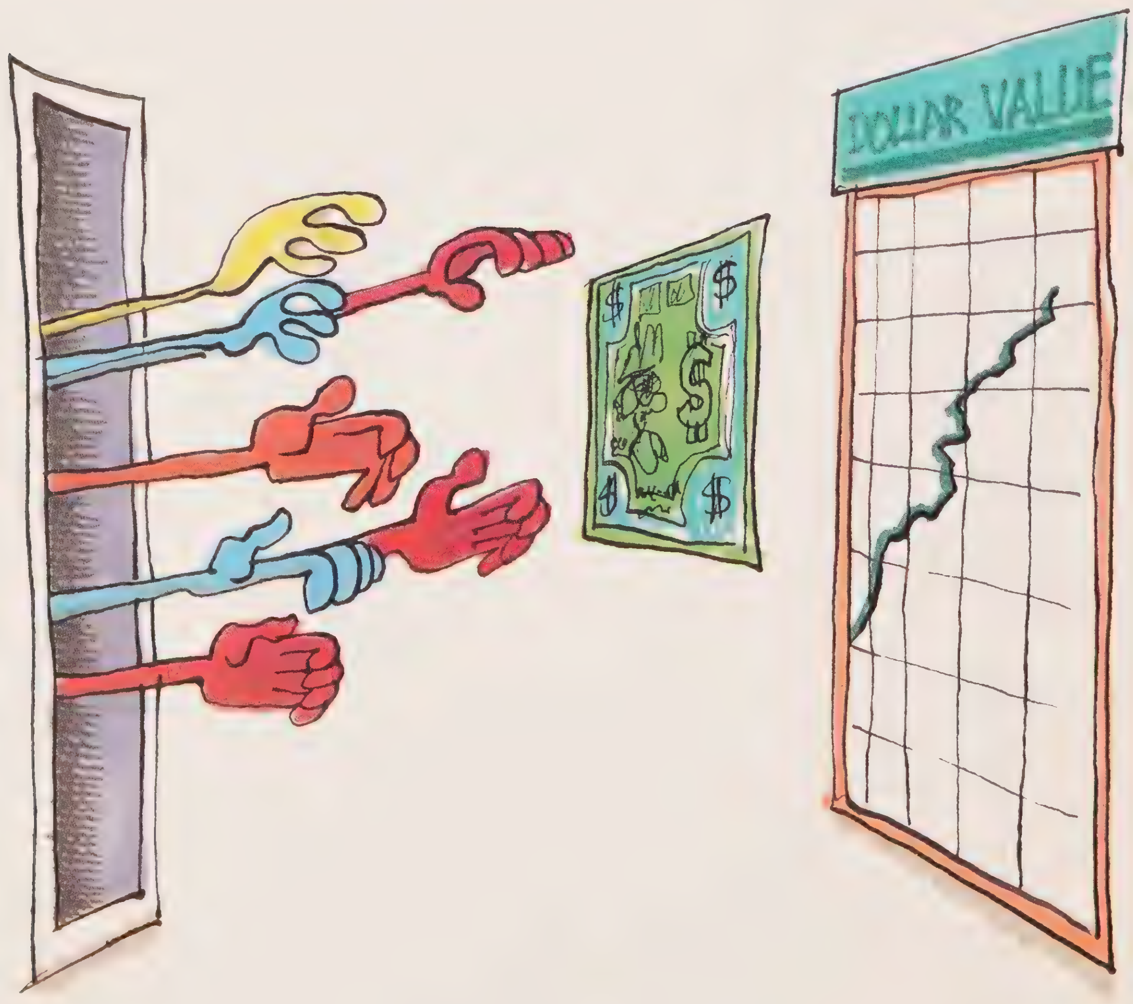
One use of foreign reserves is to support the value of the dollar. It works this way. Suppose the supply of Canadian dollars is exceeding the demand in foreign money markets and the value of the dollar is declining. The Bank of Canada can use some of its foreign reserves to buy Canadian dollars. This extra demand can boost the value of the Canadian dollar.

> *A trader said the Bank of Canada entered the* [*foreign exchange*] *market, buying back some of the U.S. dollars it used earlier to defend the currency when it sagged.*[2]
> — The Globe and Mail, Toronto

The Bank of Canada would naturally prefer not to use its reserves for this purpose. The hope would be that the demand for our dollar would be strong enough to keep its value up. However, if it is deemed necessary the Bank will step in to support the value of the dollar.

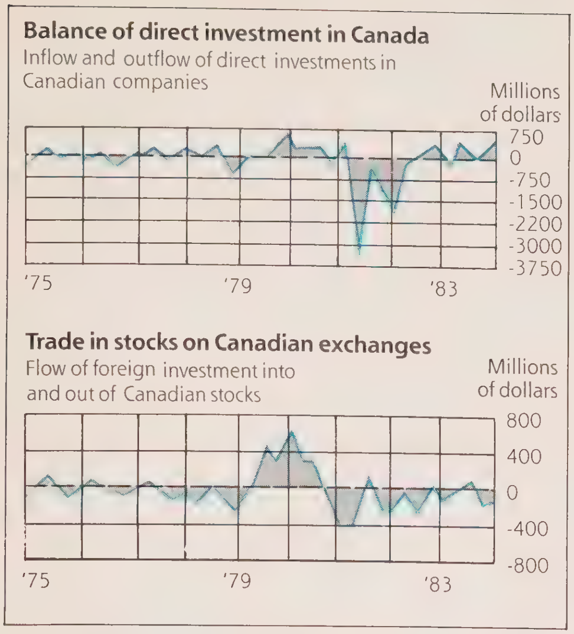
Support for the dollar can come in many forms. Any activity which results in increased demand for Canadian dollars supports its value. Recall that those who wish to buy our exports usually have to pay for them with Canadian dollars. Foreign investors, similarly, who wish to deposit money in our financial institutions to earn interest, have to deposit Canadian dollars. Therefore, another way to increase demand for the dollar is to increase deposits in Canadian financial institutions by foreign savers/investors.

Increasing the flow of investment money into Canada can be achieved in a fairly straightforward way. If a person in Spain was looking to deposit a large sum of money somewhere to earn **interest**, how would we attract that money to Canada? Like any sound investor, the Spanish



Increased demand for the dollar increases its value

Visual 3



Cansim-Telichart

The Toronto Star, June 9, 1984.

depositor would want to earn the highest rate of interest possible. To attract the Spanish deposit, we can increase our interest rates. Increasing interest rates attracts foreign capital — which must be used to purchase Canadian dollars before it can be deposited here.

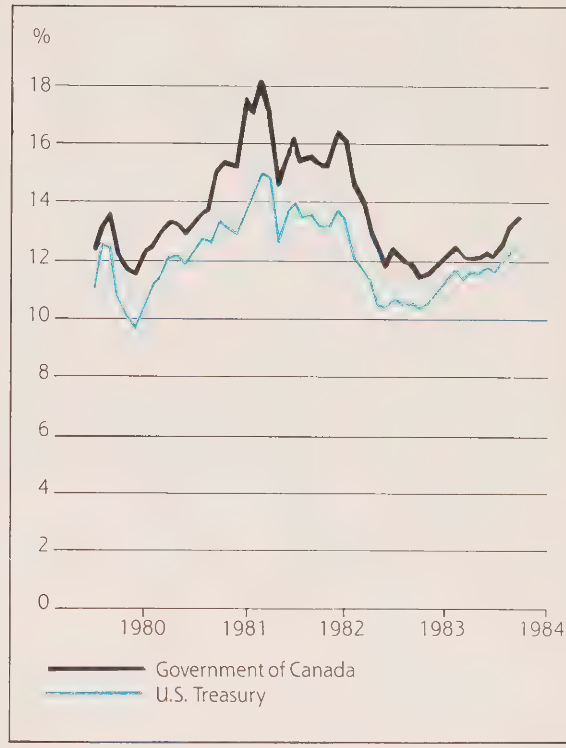
Therefore, by raising interest rates we can attract foreign capital. This increases demand for the dollar and helps support the value of the dollar.

This helps to explain why Canada has tended to raise interest rates when the U.S. has raised its rates. If the U.S. interest rate is higher than the Canadian rate this can have two effects. New money for deposit will probably go to the U.S. rather than here (therefore, the U.S. dollar would be strengthened) and money invested in Canada may be moved instead to the U.S. Foreign investors may withdraw Canadian dollars from financial institutions here, sell them and buy U.S. dollars. They could then deposit the U.S. dollars in U.S. financial institutions. The result is that the supply of Canadian dollars rises, the demand falls and the value of the dollar declines. (You'll note from Visual 4 that Canadian interest rates have not fallen below U.S. rates recently. The Government of Canada has aimed to avoid the consequences described above.)

> *Canada's strong export performance hasn't been helping the weak dollar lately, which is more influenced by interest rates and the strength of the U.S. dollar. . . Lower interest rates mean that investors won't be as interested in investing in Canada, which lowers demand and the price of Canadian dollars. . . In the long run, however, the trade figures will influence the dollar. . .*[3]
> — The Toronto Star

Visual 4

LONG-TERM RATES: CANADA-UNITED STATES
Monthly



Bank of Canada Review, May 1984

Visual 4 shows that Canada's long term interest rates have been higher than the U.S.'s since 1980. Why? What do you think would have been the implications for Canada if our rates had been lower than those in the U.S.? Compare this Visual with Visual 5 which shows the value of the Canadian dollar in U.S. dollars. Do they compare as you would expect?

In summary, we can increase demand for Canadian dollars (and support their value) by keeping our interest rates competitive with other countries' and attracting foreign capital.

While we're at it, and since we're already in this far, let's take it just a couple of steps further.

Suppose you have struck it rich and you are looking to invest your money. There are quite a number of options available to you — stocks, bonds, gold and so on. One thing you could invest in is currencies. For example, if you thought that the U.S. dollar was going to rise in value over time, you might buy some U.S. dollars. You would then wait for the value to rise and sell them for a gain.

International investors have a great deal of money invested in currencies. Their demand for currencies affects the value of each one. For example, if investors throughout the world thought the value of the Canadian dollar was going to rise they might purchase our dollars as an investment. That would increase demand for our dollar and, therefore, increase its value.

Therefore, the important point to realize is that if Canada's economy is strong and growing, investor confidence in our economy will build. This can lead to increased investor purchases of the Canadian dollar and help to maintain its international value.

> [*Projections are for*] *a slightly wider* [*trade*] *surplus of $10.9 billion for the rest of the year* [*1984*] *and a full year surplus of $20.8 billion. . . The trend is an obviously healthy one for the country's balance of payments and could produce some strengthening for the Canadian dollar.*[4]
>
> — The Globe and Mail, Toronto

To summarize, exports help increase the value of our dollar because other countries buying our products purchase Canadian dollars. As well, strong export sales can increase confidence in the Canadian economy, increase investment in Canadian dollars and further help to increase the value of our dollar. Exports have a double-barreled influence on the value of the Canadian dollar.

Not only do our exports affect the value of our money but the international value of our money also affects our exports. This follows logically from what was just discussed.

When a country buys our products it has to use its currency to buy Canadian dollars. What if the value of the Canadian dollar falls? The other country will now be able to buy more Canadian dollars with the same amount of its own currency; its money is now worth more in Canada. Our exports are cheaper to other countries when the value of our money falls. We will therefore tend to sell more exports as the value of our dollar declines.

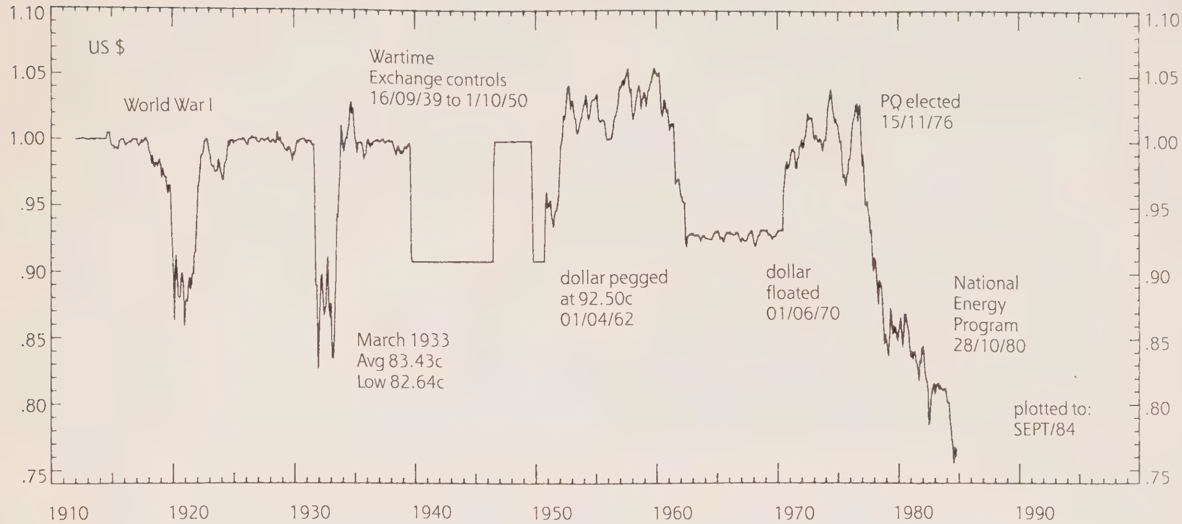
To conclude, there is a close relationship between our exports and the value of our dollar. Exports help to increase the value of our dollar and a lower valued dollar helps increase our export sales. Canada would not want to increase exports by means of a low valued dollar — this would imply that our economy is weak. Instead, Canada would rather have export sales increase due to our products being competitive in their quality and price even given a strong dollar.

Few people in Canada would want to see the value of our money steadily decline. That would mean we would pay more for our imports, leading to **inflation**. Confidence in our economy would weaken and neither Canadians nor foreigners would be anxious to invest here. About the only thing good about a cheap dollar is that it encourages sales of our exports — at least temporarily.

Investors put their money where the potential return on their investment is highest

Visual 5

CANADIAN DOLLAR
MONTHLY AVERAGE EXCHANGE RATE IN U.S. DOLLARS



The Bank of Nova Scotia
Economics Department

Visual 5 shows the value of the Canadian dollar in terms of the U.S. dollar from 1910 to 1984. Why do you think:
(i) our dollar declined dramatically from 1915 to 1920?
(ii) our dollar rose so quickly in the early '20s?
(iii) our dollar fell so quickly and far in the early '30s?
(iv) our dollar was at a constant value from the early to mid-forties?
(v) our dollar declined dramatically in the early '60s?

The point should be made here that, although we would generally prefer our dollar to be strong on international markets, a weak economy may benefit from a weaker rather than stronger dollar. If a weak economy attempts to keep the value of its currency too high, this can hurt the economy further. Naturally, Canadians hope that our economy does not weaken to the point where we are pressured to let the value of our currency fall.

Recall that at one point we assumed money only moved into and out of Canada to buy and sell imports and exports. In reality money moves into and out of Canada for a large number of reasons. The total flow of money into and out of Canada is very important to our economy and determines the value of our money.

Money flowing into and out of Canada for trade — exports and imports — is described by statistics called the balance of trade statistics. Total money flows into and out of the country are summarized in our balance of payments. Let's take a brief look at each of these.

CHAPTER III

THE BALANCE OF PAYMENTS

The **balance of payments** is the balance between what Canadians pay foreigners in a year and what foreigners pay us in a year.

The payments are separated into two major categories — the **current account** and the **capital account**.

■ THE CURRENT ACCOUNT

The current account shows three major areas of payment flows:

— money flowing into and out of Canada in payment for merchandise

— money flowing into and out of Canada in payment for services

— money flowing into and out of Canada in the form of transfers.

Services include such things as tourism payments and receipts for shipping and freight, banking and other business services, and the interest and dividends paid on loans and investments.

Transfers refers to money flowing into and out of Canada for such reasons as inheritances and the transfer of money from Canadian residents to families in other countries and vice versa.

The following is a hypothetical example of a current account balance.

Current Account

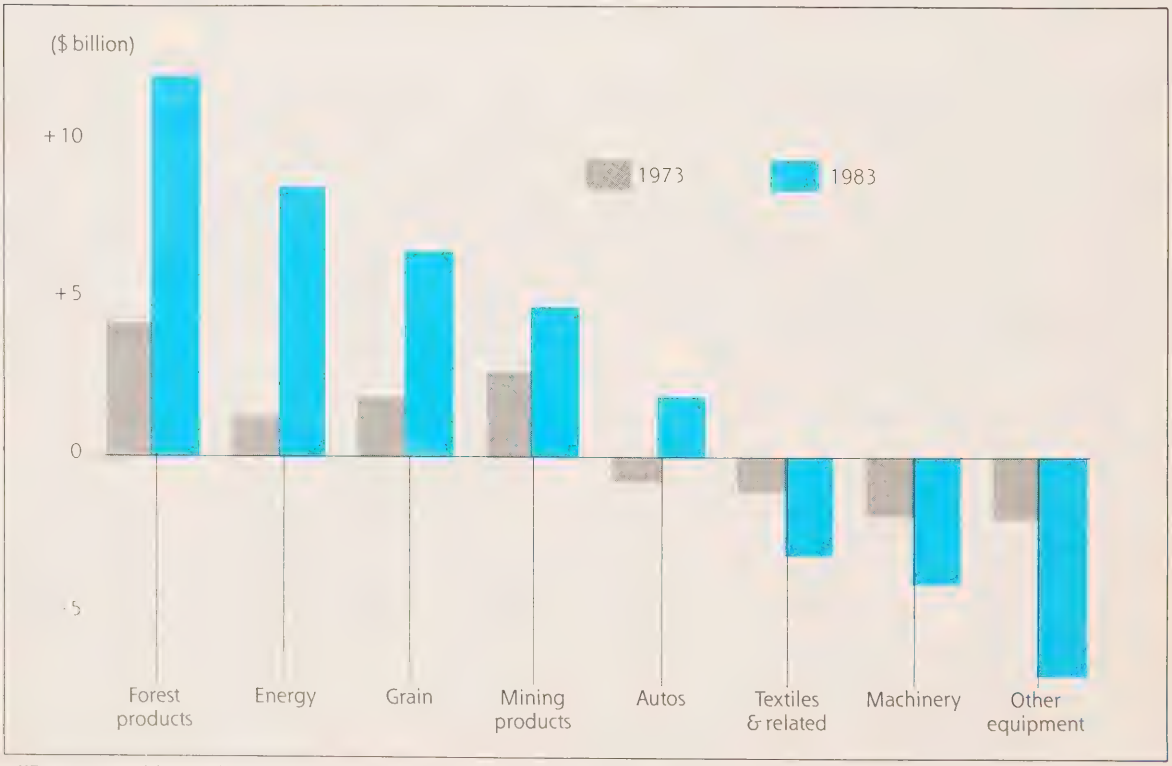
(Figures in millions of dollars)

	Amount Received (Exports)	Amount Paid (Imports)	Balance
Merchandise Trade .	52,500	49,000	+3,500
Non-Merchandise (Services) Trade .	9,500	18,500	−9,000
Transfers	1,500	1,500	—
Total	63,500	69,000	−5,500

Visual 6

SELECTED TRADE BALANCES

Natural resources were the major contributors to the increase in our goods trade surplus — particularly forest products, energy and grains. However, a turnaround in auto trade and depressed capital investment, keeping down machinery and equipment imports, also has helped.



"Enormous strides made in trade over a decade." **The Financial Post**, March 31, 1984.

According to Visual 6, which sector made the most positive contribution to our trade balance in 1973? Which was the largest negative contributor in 1973? If you look at the categories in terms of resource industries and manufacturing industries, which made a positive contribution? Which industry changed from a deficit to a surplus from 1973 to 1983?

In this example, the value of Canadian imports exceeds the value of our exports. The money to pay for these imports has to come from somewhere. This will be addressed in our discussion of the capital account.

The merchandise section of the current account is often referred to as Canada's **balance of trade**. Visual 6 compares the relative performance of some of the more important industries. Historically, Canada has had a surplus in its merchandise trade and a deficit in its services trade (as in the hypothetical example). Table 1 presents Canada's current account position since 1960.

THE CAPITAL ACCOUNT

The capital account is a group of statistics measuring the flows into and out of Canada of just that — capital. Capital is a term used to refer to money flowing in and out for investment in establishing businesses, buying stock, depositing savings in financial institutions, and so on.

As you might be aware, if you are fortunate enough to have money to invest, you can choose to invest your money in longer term investments — such as investments in companies, purchasing stocks or bonds, etc. — or in

Table 1

CANADA'S CURRENT ACCOUNT TRADE, 1960 TO 1983
(Balance of Payments Basis)

Year	Goods Exports	Goods Imports	Trade Balance	Goods and Services[1] Exports	Goods and Services[1] Imports	Total Current Account Balance
			(millions of dollars)			
1960	5,392	5,540	−148	7,215	8,448	−1,233
1961	5,889	5,716	173	7,904	8,832	−928
1962	6,387	6,203	184	8,548	9,378	−830
1963	7,082	6,579	503	9,416	9,937	−521
1964	8,238	7,537	701	10,887	11,311	−424
1965	8,745	8,627	118	11,648	12,778	−1,130
1966	10,326	10,102	224	13,600	14,762	−1,162
1967	11,338	10,772	566	15,303	15,802	−499
1968	13,537	12,162	1,288	17,464	17,561	−97
1969	14,832	14,007	825	19,425	20,342	−917
1970	16,751	13,845	2,882	21,932	20,826	1,106
1971	17,788	15,533	2,255	23,051	22,620	431
1972	20,129	18,272	1,857	25,483	25,869	−386
1973	25,461	22,726	2,735	31,776	31,668	108
1974	32,591	30,902	1,689	40,352	41,812	−1,460
1975	33,511	33,962	−451	41,840	46,597	−4,757
1976	37,995	36,607	1,388	47,110	50,952	−3,842
1977	44,253	41,523	2,730	54,103	58,404	−4,301
1978	53,054	49,047	4,007	64,577	69,512	−4,935
1979	65,275	61,157	4,118	79,182	84,144	−4,962
1980	76,772	68,284	8,488	93,615	94,711	−1,096
1981	84,480	77,112	7,368	100,628	107,946	−5,766
1982	84,577	66,239	18,338	101,438	99,863	3,017
1983	91,268	73,227	18,041	108,181	107,488	1,577

[1]including transfers

Source: Statistics Canada.

Canada. Department of External Affairs. **A Review of Canadian Trade Policy, A Background Document to Canadian Trade Policy for the 1980s.** Ottawa: Supply and Services Canada, 1983; Statistics Canada. **Quarterly Estimates of the Canadian Balance of International Payments.** Quarterly. Catalogue no. 67-001; Statistics Canada. **Canadian Statistical Review, Historical Summary 1970.** Occasional. Catalogue no. 11-505.

Table 1 shows that from 1960 to 1983 our trade balance was positive for all but two years. Meanwhile it also shows that during that period our total current account balance was negative for all but five years. What does this imply about our balance in service trade?

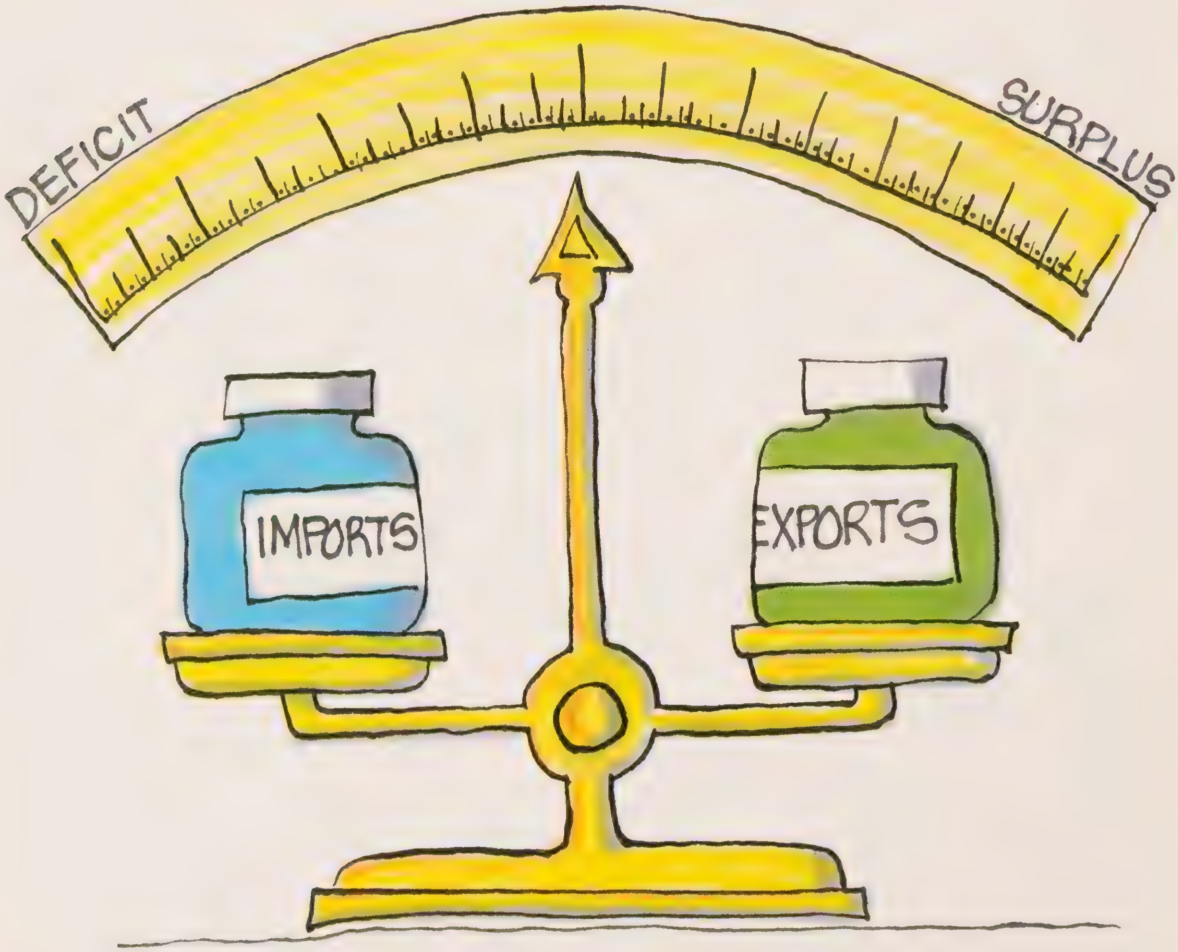
Table 2

FOREIGN INVESTMENT IN CANADA
($ million)

	1970	1974	1975	1976	1977	1978	1979	1980	1981	1982
Total investment	44,232	60,663	69,283	82,143	91,599	103,029	115,441	129,000	149,400	163,000
Direct investment	26,423	36,385	37,389	40,311	43,683	48,250	54,260	61,600	65,200	67,000
% of total . . .	60	60	54	49	48	47	47	48	44	41
Portfolio	14,790	20,754	28,197	37,687	43,462	50,141	56,485	62,200	78,700	91,000
% of total . . .	34	34	41	46	47	49	49	48	53	48

"Need for jobs puts FIRA's role in doubt" by Jennifer Lewington. **The Globe and Mail, Toronto**, December 10, 1983.

According to Table 2, has the proportion of foreign investment to total investment in Canada been rising or falling in recent years? Why? Portfolio investment has tended to be increasing as a percentage of total investment in recent years. In which year did portfolio investment begin to exceed direct investment? What do you think are the implications of this shift?



Balance of trade

short-term investments — treasury bills, terms deposits, etc. all with maturity dates of less than one year. (Maturity date means that the term of your investment is complete and you will have to reinvest those funds.)

The capital account is divided into two major categories — money flows into and out of Canada for long-term investment and for short-term investment.

A further clarification might be helpful. Some long-term investment is referred to as **direct investment** while some other is referred to as **portfolio investment**. Direct investment refers to such money as that invested in the creation or expansion of businesses. Money spent in Canada by a U.S. company setting up a branch plant would represent direct investment. Portfolio investment refers to money invested in such things as stocks and bonds.

The following is a hypothetical capital account for Canada. Note that the net figures shown refer to the final relationship between inflows and outflows. For example, if Canadian direct investment in other countries were $500 million and foreign direct investment in Canada were $700 million, the net result would be a flow into Canada of $200 million. This would be shown as +$200. If it were the reverse, the $700 million flowed out while $500 million flowed in, this would be shown as -$200 since a net of $200 million would flow out of Canada.

Capital Account

(Figures are in millions of dollars)

Long-Term		
Direct Investment	−2,000	
Portfolio Investment	+5,000	
Other Long-Term Investments	+1,000	
Balance on Long-Term		+4,000
Short-Term		
Net Short-Term		+300
Total Capital Account Balance		+4,300

Table 3

SUMMARY OF THE CAPITAL ACCOUNT AND TOTALS OF CANADA'S BALANCE OF INTERNATIONAL PAYMENTS

	1976	1977	1978	1979	1980	1981	1982	1983
	(billions of dollars)							
Direct investment in Canada	−0.3	0.5	0.1	0.8	0.8	−4.4	−1.4	0.2
Direct investment abroad	−0.6	−0.7	−2.3	−2.6	−3.2	−6.9	−0.2	−2.5
Portfolio transactions	8.7	5.4	5.0	3.4	5.0	10.9	11.3	5.2
Other capital movements in long-term forms	0.3	0.8	0.3	0.5	−1.4	−0.5	−0.6	0.1
Balance of capital movements in long-term forms	8.0	4.3	3.2	2.1	1.2	0.1	9.1	2.8
Resident holdings of short-term funds abroad	−1.2	0.7	2.1	4.2	0.8	10.7	−7.0	2.3
Non-resident holdings of Canadian dollar deposits, government demand liabilities, treasury bills, etc., and other short-term capital transactions	1.7	0.1	−0.6	2.9	−1.0	5.2	−1.6	0.5
Balance of capital movements in short-term forms	0.3	0.9	1.5	7.0	−0.2	15.9	−8.8	2.8
Total Net Capital Balance	8.4	5.2	4.7	9.1	1.0	16.0	0.3	5.5
Total Current and Capital Account Balance	4.3	0.8	−0.2	4.3	−0.1	10.3	3.3	7.1
Net errors and omissions	−3.8	−2.3	−3.1	−2.6	−1.4	−9.0	−4.0	−6.6
Special Drawing Rights (SDR) allocation	—	—	—	0.2	0.2	0.2	—	—
Official international reserves	0.5	−1.4	−0.2	−0.9	−0.5	0.4	−0.7	0.5
Official monetary liabilities	—	—	−3.1	2.8	−0.7	1.0	—	—
Net official monetary movements	0.5	−1.4	−3.3	1.9	−1.3	1.4	−0.7	0.5

Note: Balances may not be the sum of the detail due to rounding.

Statistics Canada. **Quarterly Estimates of the Canadian Balance of International Payments.** Quarterly. Catalogue no. 67-001.

As you will recall, the hypothetical current account balance was − 5,500 (millions of dollars) and the capital account balance is + 4,300 (millions of dollars). The truth of the matter is that these two figures must balance. Every dollar that is bought must be sold by someone, and every dollar that is sold must be bought by someone. The dollars bought must equal dollars sold. Therefore, the flows must balance. When the goods and services Canadians buy from abroad are worth more than the goods and services we sell abroad, that difference must be made up in some way.

The difference will be made up in capital flows, such as direct and portfolio investments in Canada and outflows of government reserves. Recall from the discussion of the value of the dollar that the government holds official reserves of gold, foreign currencies, **Special Drawing Rights** (SDRs), etc. Imbalance in the accounts will be partially addressed by flows of government reserves. This appears as Net Change in Official Reserves.

Furthermore, collecting information on all the various flows is very difficult. Because the capital and current accounts must balance, a statistic is added which is called Net Errors and Omissions. This acknowledges that there are flows which haven't been measured or which haven't been measured accurately.

Both of these figures, Net Change in Official Reserves and Net Errors and Omissions, are added to the capital account so that we get the following hypothetical example.

Note that now the current and capital accounts balance to 0.

(Figures are in millions of dollars)

CURRENT ACCOUNT BALANCE			−5,500
Capital Account			
Long-Term			
Direct Investment . . .	−2,000		
Portfolio Investment . . .	+5,000		
Other Long-Term Investment . . .	+1,000		
Balance on Long-Term . . .		+4,000	
Short-Term			
Net Short-Term .	+300		
Net Change in Official Reserves	+400		
Net Errors and Omissions . . .	+800		
		+1,500	
CAPITAL ACCOUNT BALANCE			+5,500

The balance of payments, then, is a statistical summary of the flows of money into and out of Canada.

Now, after looking this closely at a lot of the ins and outs of trade, it might be best to look at the benefits of export trade.

CHAPTER IV

THE ECONOMIC BENEFITS OF EXPORT TRADE

One out of every five Canadians has a job that depends directly on exports. That represents a large proportion of our population. Clearly when Canada improves its export position, jobs are created. If Canada's exports decline, some Canadians may lose their jobs. Visual 7 shows the importance of exports to Canada relative to some other countries.

> *About 70 percent of all Canada's exports are manufactured goods and it is estimated that this provides jobs for 1,500,000 Canadians.*[5]
> — Roy Phillips, President, The Canadian Manufacturers' Association

To understand the connection between jobs and exports, it is important to understand the factors that create jobs.

Consider a company which produces baseball bats and hockey sticks. What would determine the number of employees required? Obviously, a major determinant would be the number of sticks and bats which the company needed to produce. To produce more usually means the need for more workers. The amount of labour required will be related to the demand for the product.

For a company selling sticks and bats in Canada there will be a limited demand because of our relatively small population.

Canadian companies producing sticks and bats would sell more if they could sell outside of Canada as well. If successful, this would increase the demand for the products and also the need for labour.

In general, if Canadian companies are more successful in selling their products to other countries, this can help to increase employment in Canada. So one benefit of exporting is:

1. Exports Help Maintain and Create Jobs in Canada

For another benefit from trade, let's consider **economies of scale**. The company producing hockey sticks and baseball bats will have to pay expenses for production.

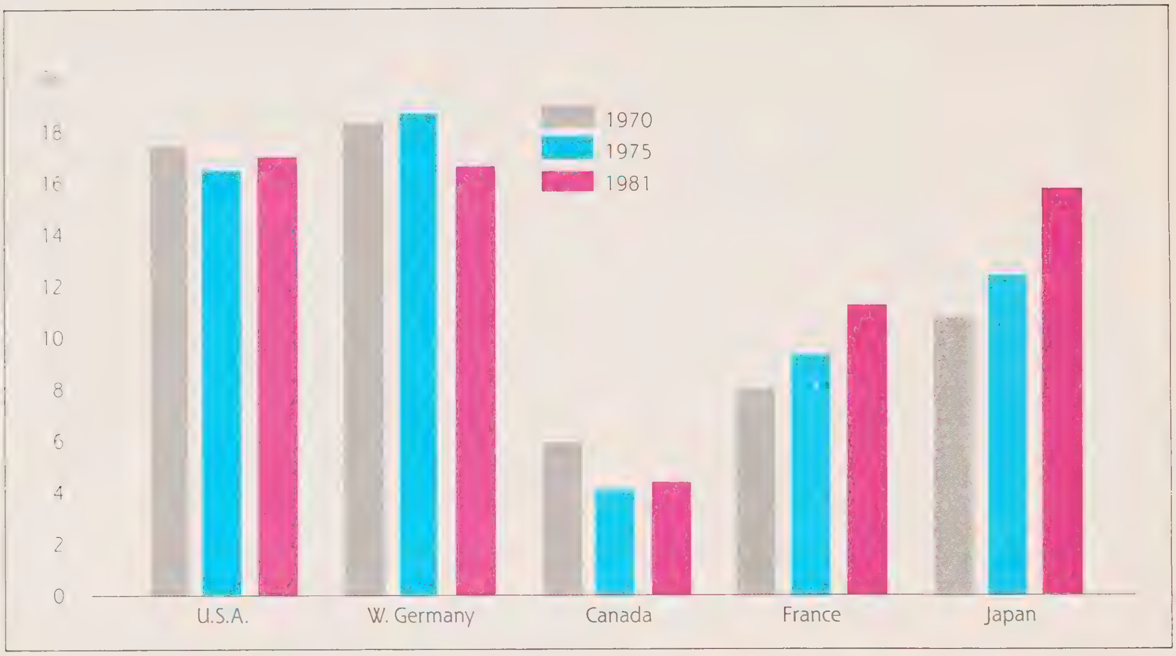
To keep the business operating, the company would aim to sell the products to cover expenses and return a **profit**. The revenue from sales will depend on the price of the product and the number sold. It is a logical economic principle that, the lower the price of a product, the more that will likely sell (consumers are pretty rational people). So the price charged is very important in determining how much will be sold.

Suppose the total cost was $250,000 to set up the hockey stick and baseball bat company, and it was selling only in Canada. Suppose further that the company could produce and sell about 20,000 units in Canada (assuming bats and sticks cost the same to produce and

Exports help create and maintain employment

Visual 7

SHARES OF WORLD EXPORTS OF MANUFACTURED GOODS



Ontario. Ministry of Industry and Trade. Trade Policy and Analysis Branch. **Ontario Exports Mean Jobs**. Toronto: Ontario. Ministry of Industry and Trade, n.d.

According to Visual 7, which country has made the largest gain from 1970 to 1981 in terms of its share of world exports of manufactured goods? Which countries' shares have declined during this period? Which countries' shares have grown?

sell for the same price). What would the unit cost be? That is, how much would it cost to produce each bat and stick?

$$\text{Unit Cost} = \frac{\text{Total Cost}}{\text{Number Produced}} = \frac{\$250{,}000}{20{,}000} = \$12.50$$

Therefore, to cover total costs and earn a 10% profit for the company, a price of $12.50 + (10% of $12.50 = $1.25) = $13.75 would have to be charged.

Now, suppose that the average price (in Canadian dollars) for a hockey stick or baseball bat in the United States was $10.00. The price of $13.75 would lead one to believe that the product wouldn't be very competitive in the U.S. But consider the following situation.

Current Total Cost =	$250,000
Current production of bats and sticks:	20,000
Current production capacity:	30,000
Total Cost if produced at capacity:	$270,000
Current unit cost: $\frac{\$250{,}000}{20{,}000}$ =	$12.50
Unit cost if produced at capacity: $\frac{\$270{,}000}{30{,}000}$ =	$ 9.00

As shown, if more output could be produced and sold (30,000 bats and sticks rather than 20,000) the unit cost would fall from $12.50 to $9.00. The larger quantity of output would lower the unit cost and enable a lower price ($9.00 + 10% of $9.00 = $9.90).

Increased production, therefore, can be good for Canadian consumers since it means they pay a lower price. Higher volumes also lead to increased exports due to more competitive prices.

Our example showed that as output was increased, total cost increased ($250,000 to $270,000). This is understandable. Businesses will have certain fixed costs (costs which are the same whether one unit or 1000 units are produced) and variable costs (costs which increase as output increases). An example of a fixed cost would be rent for a building which would be the same regardless of the level of production in the building. An example of a variable cost would be the wood used in the bats and sticks. As more are produced, more wood will be required and the cost for wood will rise.

Whether a company can achieve economies of scale through expanded output will depend on how much total cost increases. For instance, in our example, if the total cost to produce at capacity (30,000) rose to $400,000, then the unit cost would rise to $400,000 ÷ 30,000 = $13.33. This would lead to a higher price (**diseconomies of scale**).

Quite often businesses can achieve economies of scale through expanding production and sales. However, it is important to note that this is not the case for all business.

Therefore, in addition to creating jobs, increasing Canada's exports can also do the following:

2. Exports Can Lead to Lower Prices for Canadian Consumers by Lowering Unit Costs (i.e. enabling economies of scale).

3. Lower Unit Costs and Prices Increase the International Competitiveness of Canadian Products and Businesses.

4. Exports Can Increase Sales for Canadian Companies and Increase Profit.

5. Exports Can Lead to Increased Output Necessitating Expanded Production Capacity. This Leads to Increased Investment.

Imagine now that the stick and bat company begins to export. Competition is pretty stiff in other countries but the Canadian company is holding its own. If only it could get an edge, in some way, on its competitors, it could expand the business even further — produce more, sell more, employ more labour and earn a higher return.

In watching the Oilers and the Canadiens one night, an employee with the company sees a defenceman break his stick in half on a slap shot from the blueline. The thought arises — if there was only a way to reinforce the shaft of the stick, without adding weight to the stick, the company could gain that competitive edge.

> *Most Canadian firms will have to be internationally competitive and for most this will mean selling abroad. Achieving economies of scale that exporting makes possible will be the key. Furthermore, exposure gained in export markets will be a valuable guide for the type of competition to expect at home as import penetration grows.*[6]
>
> — Roy Phillips, President, The Canadian Manufacturers' Association

The employee proposes her idea and the company decides to hire a researcher for six months to see if it can be done.

This illustrates two more benefits which are possible from exports:

6. Exporting Motivates Producers to be Competitive (i) because of the increased numbers of competitors and (ii) because of the greater potential rewards for gaining a competitive edge.

7. Exports Can Lead to Increased Research to Find Improvements and to Gain a Competitive Edge.

This drive for competitiveness and increased research can be good for us all because it can lead to new and better products.

Consider another possible benefit of exports.

Suppose you are running the stick and bat company. One day one of your employees comes to you with an idea.

Economies of scale: longer production runs often lead to lower unit costs and lower prices

Using this idea, reorganizing the plant and people's tasks, you could increase output by 20% without increasing the number of machines or employees. There would be an initial investment for reorganizing, but that would be all.

Basically, what you've been informed of is a way to increase **productivity** — to expand output using the same input. Increased productivity/efficiency can lower unit cost, therefore price, and make your product more competitive. You can sell more and increase your revenue. The increased profit can then be used for further investment, research, further compensation to employees (particularly if they come up with suggestions like this one) and so on.

Therefore, another potential benefit of exporting is:

8. Exporting, by Encouraging Businesses to be More Competitive, Encourages Increased Productivity/Efficiency.

In summary, by exporting Canada's goods and services to other countries, we stand to benefit in many ways.

Table 4

CANADA'S TOP 15 EXPORTS – 1983

Commodity Grouping	**Value** (in millions of dollars)
Road motor vehicles	$14,055.2
Motor vehicle parts	5,752.6
Wheat	4,647.7
Newsprint paper	4,005.1
Lumber	3,969.1
Natural gas	3,958.2
Crude petroleum	3,456.9
Wood pulp	3,057.6
Machinery	2,918.8
Other equipment and tools	2,761.3
Chemicals	2,173.6
Non-metallic minerals	2,082.6
Non-ferrous metals and alloys (excluding aluminum, copper, nickel, zinc)	1,977.3
Miscellaneous end products	1,800.8
Aluminum	1,744.2
TOTAL EXPORTS	$90,963.9

Statistics Canada. **Canadian Statistical Review.** Monthly. Catalogue no. 11-003

Table 5

CANADA'S TOP 15 IMPORTS – 1983

Commodity Grouping	**Value** (in millions of dollars)
Motor vehicle parts	$ 9,333.2
Road motor vehicles	7,904.4
Crude materials, inedible	7,201.1
Machinery	6,805.7
Food, feed, beverages and tobacco	4,870.3
Miscellaneous end products	4,330.3
Personal and household goods	3,421.7
Communication and related equipment	3,315.1
Crude petroleum	3,274.0
Office machines	3,109.5
Aircraft and parts	1,814.5
Measurement and scientific equipment	1,507.0
Plastics and synthetic rubber	1,361.4
Organic chemicals	1,265.8
Metal fabricated basic products	1,169.9
TOTAL IMPORTS	$75,586.6

Statistics Canada. **Canadian Statistical Review.** Monthly. Catalogue no. 11-003

Table 4 indicates Canada's major export products. Canada is noted for being an exporter of primary products yet our highest exports are motor vehicles and motor vehicle parts. Why do you think these are our major areas of export? After motor vehicles and parts, the next 13 major exports are largely products. What advantages do you think there would be for Canda if we could increase the degree of processing of our primary products prior to export?

Table 5 indicates Canada's major imports. Why do you think motor vehicles and motor vehicle parts are our largest imports as well as our largest exports? (See Table 4) Note the number of manufactured goods that make up our list of major imports. Can you think of any reason why Canada is both a major exporter and importer of crude petroleum?

CHAPTER V

THE IMPORTANCE OF IMPORTS

Trade is a two-way street

Given all the benefits that export can bring, one might be tempted to think it would be ideal for Canada simply to export and not import at all. But the discussion of comparative advantage showed this wasn't true. Canada can benefit from imports — and trade is a two-way street.

There are a number of ways in which imports are important to the Canadian economy. To appreciate this, consider some of the reasons why we import goods and services from other countries.

- Canada may not have the resources required to produce a good or service (e.g. bananas don't grow in Canada's climate).

  Importing makes certain goods and services available to Canadians that we would otherwise never be able to obtain.

- Other countries may produce a better quality product than Canada.

  Importing under these conditions can bring certain benefits. First, it makes a better quality product available to Canadians. Second, it can encourage Canadian producers to find ways of producing a product which is as good or better than the import.

- Other countries may be able to produce a good or service at less cost than Canada.

  This, of course, means that the other country would have a comparative advantage over Canada. It could be to Canada's advantage to specialize in other areas of production and import the lower cost items. Alternatively, Canadian producers could look for ways to lower costs and compete with more inexpensive imports.

- Producers in other countries may simply be producing something that no Canadian **entrepreneur** has undertaken to produce.

  This has a number of advantages. For one thing, it makes new products available to Canadians. Second, it may encourage Canadian entrepreneurs to establish a competing enterprise. Third, it may encourage Canadians to become entrepreneurs in some other type of production once they see the potential gains from a successful idea. All in all, it helps encourage a dynamic economy in Canada.

- As mentioned, trade is a two-way street. If Canadians want to export to other countries, it is understandable that other countries want to export to Canada. If Canada only wants to export and not import, where is the incentive for other countries to trade with us? They would see us as wanting to take and not give. This would not encourage healthy trade partnerships.

The discussion of comparative advantage illustrated how two countries mutually benefit from trade. This must be kept in mind. If Canada tries only to export without importing, the benefits of specializing will be lost.

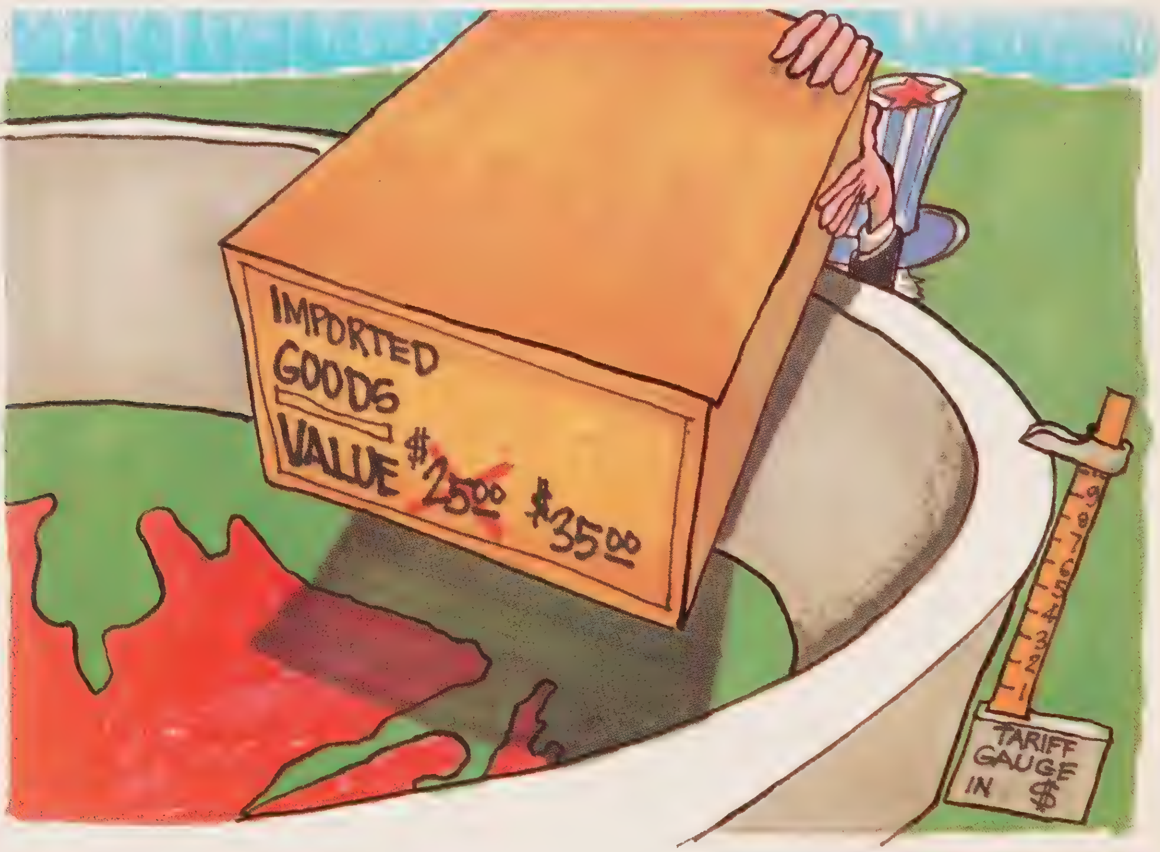
- In a broader sense, by importing Canada is putting money into other countries. In this way, we are helping the economies of these other countries. As various countries' economies improve, the overall standard of living in the world can rise.

> *Why do companies enter the international market?. . . I might add, with hindsight, the sense of achievement it brings. . . There is a great deal of human satisfaction in knowing that you have helped to make life better for people in other parts of the world where they must often overcome great disadvantages of geography and climate.*[7]
> — Camille A. Dagenais, Chairman, The SNC Group
>
> *Without foreign markets a trading country cannot produce and employ its workers. Without production it cannot afford to import the products of other countries.*[8]
> — Maclean's

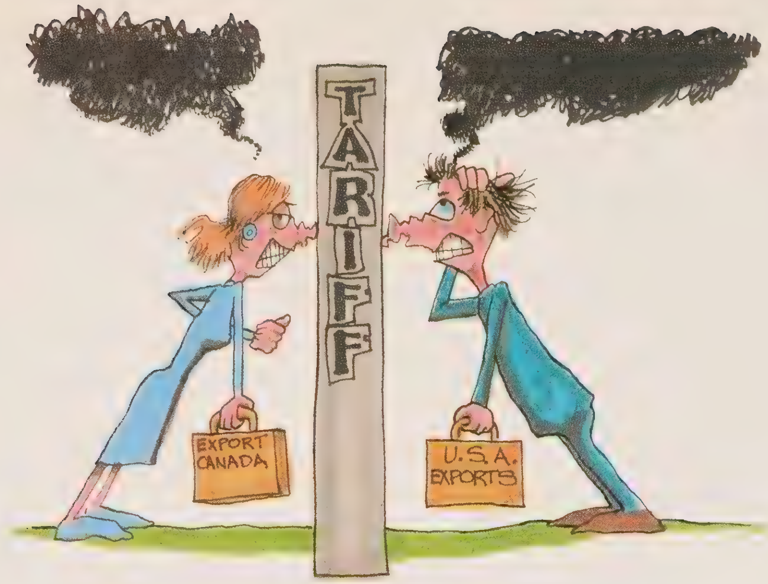
Canada is part of a global economy. We must recognize the responsibilities that come with that. If Canada's economy improves while our trading partners' decline, sales to those countries will ultimately decline. The healthier all economies are in the world, the better for Canada because of greater opportunity for export sales, more effective import competition and an improvement in the world's living standard and all the welfare improvements that this implies.

Therefore, competition from lower cost/lower priced imports can lead to benefits from trade for Canada (if we specialize in other areas and buy the cheaper imports). Imports can also encourage more efficiency and higher productivity from Canadian producers.

In conclusion, although exports are vital to the Canadian economy, it is important to recognize the key role of imports as well. But to import, to buy goods and services from other countries, we must export. The better our success at exporting, the better position we will be in to import those things we seek from abroad.



Tariffs raise the price of imports



Tariffs are a barrier to trade

■ AN ISSUE IN CANADA

Very few economic choices — maybe none — can be explained in clear black and white terms. **Tariffs** as protection against lower-priced imports raise an issue of some dispute in Canada.

Canadian consumers would benefit from the lower priced competition. It means more choice and lower prices.

But Canadian business people would probably see things differently. They would see potential business going to foreign competitors, meaning lower sales, less revenue and hence less profit or a loss.

An employee of a Canadian company trying to compete with these cheaper imports might become unemployed if enough business was lost to foreign competitors.

Differences in perspective lead to differences of opinion on the issue of cheaper imports.

One way in which the Canadian government can assist Canadian businesses in their competitive battle with foreign producers is to put a tariff on certain foreign goods. A tariff is a duty placed on imported goods coming into Canada. If a business in another country wishes to sell its product in Canada, and the Canadian government has put a tariff on that product, the tariff must be paid before the goods can enter Canada.

Tariffs have the effect of raising the price at which foreign companies must sell their products in Canada. This gives Canadian firms an advantage.

The issue of tariff protection for Canadian businesses is a crucial one in Canada. Here are some of the points made on either side of the debate.

MAJOR POINTS OF THOSE ARGUING FOR TARIFF PROTECTION:

- Tariffs are necessary to protect Canadian jobs. If Canadians buy lower priced imports, Canadian production falls and some workers will lose employment.
- Tariffs are necessary to protect certain Canadian businesses (if not entire industries) from lower priced imports. Other countries may be able to produce more cheaply because of lower wage costs, cheaper resources, etc. As such, they may be able to underprice Canadian producers and put them out of business.
- There are many areas in which Canada does not have a comparative advantage. Tariffs help broaden the areas in which Canadians can compete. This can increase business opportunity and jobs.

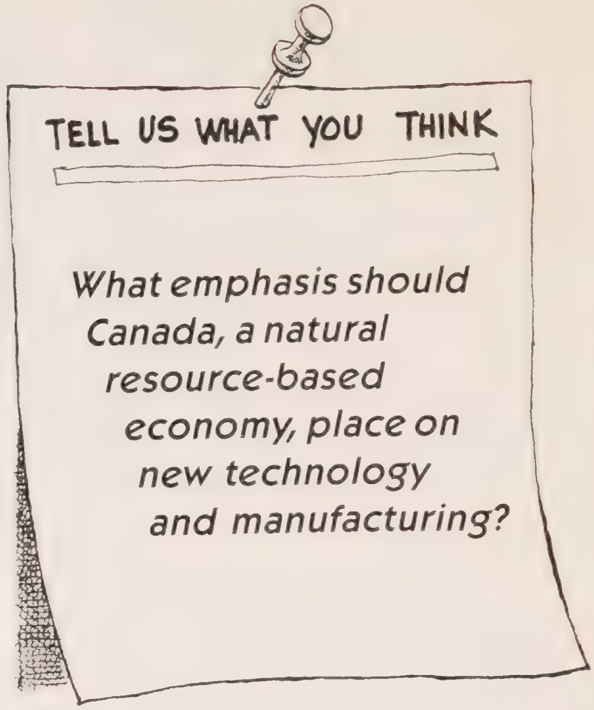
MAJOR POINTS OF THOSE ARGUING AGAINST TARIFF PROTECTION:

- Tariffs raise prices for Canadian consumers.
- Tariffs protect inefficient industries — those which can't compete on equal terms with foreign producers. They should be forced to compete or allowed to fail. If they fail, the resources invested can be redirected to a business that can compete. Companies that could compete more effectively and employ more workers should be supported.
- Levying a tariff encourages other countries to retaliate with their own tariffs on Canadian goods. This hurts the sales of Canadian exporting firms. Production and employment fall and opportunities for economies of scale are lost. Hence, prices of Canadian produced goods rise.

CHAPTER VI

CANADA'S INTERNATIONAL COMPETITIVENESS

Let's turn our attention to the major factors which affect Canada's international competitiveness and ability to trade.



■ AREAS OF COMPARATIVE ADVANTAGE

As most Canadians are aware, Canada has generally had a comparative advantage over many other countries in the area of natural resources. We are a nation blessed with a rich endowment of natural resource wealth. In the past, because of this, our resources have served as our major area of export.

Historically, Canada has not had a comparative advantage in many areas of manufacturing. To enable Canadian manufacturers to compete with cheaper imports, they have been protected by tariffs placed on foreign competitors' products. There are, today, a number of changes taking place in the world which affect Canada.

Canada still has a comparative advantage in natural resources. But resource trade is declining relative to manufacturing and high technology industries. Many people feel that Canada should actively seek to compete in the expanding manufacturing/high technology markets and aim to rely less on our resources.

> *For the first 100 years, we made our way by selling our resources. . . For the next 16, we got by on credit. From now on, we're going to have to get by on our brains.*[9]
>
> — The Honourable Michael Wilson, M.P.

Others argue that we should continue to focus on our resources. The case is made that this is particularly true when their value may rise over time as the world's resources become scarcer.

> *Keith Hay, professor of economics at Carleton University says that there is a new willingness in this country to concentrate on resource-related products, 'which have a comparative advantage and consequently relatively easy access to hungry world markets'. As Mr. Hay sees it, resource-led export growth will take the pressure off Canada to find foreign markets for more manufactured goods.*
>
> — The Globe and Mail, Toronto

Some argue against this saying the **Third World** and **developing countries** have great resource wealth, too. In a growing number of cases, they are competing directly with Canada's resource production.

> *Internationally, major shifts in comparative advantage among countries are being created by differential rates of technological advance and by the ready migration of technology to developing countries, where low labour costs and investment subsidies convey a competitive edge.*[11]
>
> — The Right Honourable Pierre E. Trudeau

■ IMPACT OF THE WORLD ECONOMY

How effective are Canadians in changing our processes of production to meet changing world conditions?

If you are a music company producing and distributing New Wave records at a time when the market is buying jazz and "middle of the road", you're in trouble. If you are producing denim blue jeans and the market shifts to cotton and linen shirts and pants, you're in trouble.

If a competitor develops a new technology which cuts production costs in half, and you can't keep pace with technological change and reduced costs, you're in trouble.

There are so many changes that can take place in world markets. Producers have to be able to adjust quickly and effectively to keep pace and maintain competitiveness.

> *The world economy of the future will be dominated by global industries. Therefore, we must provide the incentive, the wherewithal and the training for Canadians to compete in the world marketplace. This means providing first class research facilities, educational institutions and government incentive programs. If we fail, Canada will never get past the stage of being more than a supplier of natural resources.*[12]
>
> — A senior business executive

Canada's record on adaptability hasn't been that good. Studies have shown that the implementation of new technology in Canada tends to be slower than in most industrialized countries. A number of possible reasons are cited for this. Perhaps Canadian business is simply less aggressive than its competitors. Businesses, along with labour, may tend to resist the implementation of new technologies. Labour may fear that new methods will result in people losing their jobs. Finally, Canada tends to undertake less research and development than other industrialized countries to develop new technology. Regardless of the reasons, Canada has to find ways to speed up the implementation of new technology into our production processes.

On the topic of implementing new technology, some argue that Canada slows down the process of adjustment by protecting certain industries with tariffs and other barriers to trade. There are two sides to this argument. Consider the clothing industry in Canada. Canada's clothing industry has to compete in world markets which include goods from such countries as Singapore and Taiwan, Hong Kong and South Korea. As these countries have developed their clothing industries, it has been harder for Canada to compete.

Some say that Canada should adjust to this fact. We should drop protection and force the industry to either be competitive again or close down. If the industry cannot compete, the resources used should be channeled to another more competitive area.

But others argue that changing world markets shouldn't mean we do away with protection and allow those companies to fail. This would mean the loss of Canadian businesses and Canadian jobs, particularly since clothing factories and plants are often located in towns where there would be little other work for the people to do.

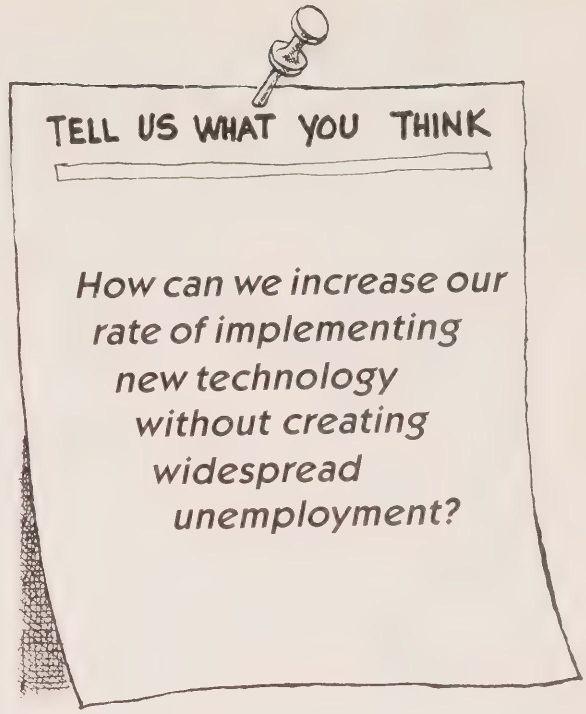
What those who talk about "structural adjustment" to meet low-wage competition never tell you is there is no end to it. There'll always be some other country. . . where the wage rate is 40 cents an hour — with which we'll never be able to compete.[13]

— Robert White, Canadian Director, United Auto Workers

White is absolutely right. But his answer, of protectionism, is wrong. What we have to do is move out of making the kinds of things that can be made cheaper in underdeveloped countries and develop new products.[14]

— David Culver, Chairman, Alcan Aluminum Ltd.

Then what's to be done? Do we force adjustment by dropping our trade barriers? Or do we maintain protection? What do you think? In many ways, it will come down to what you think. Governments decide tariffs and people decide the governments. It's an issue Canadians will have to face.



Tariffs aren't the only way we slow the adjustment process. The point is sometimes argued that when money is used to support struggling companies, it prevents that invested money from being used to start up a new company — one that might be more successful. In some cases, the argument is made that supporting a struggling company is worthwhile, if only because there has already been significant investment which would be lost. And creating new jobs may be more difficult than maintaining old ones, especially in the affected region.

This process of adjustment we're discussing — changing what is produced or how production occurs — is referred to as **rationalization**. Many are arguing that Canada now has to go through a period of rationalization. Specialize more. Expand production in certain areas. Realize economies of scale. Become more productive. Establish new companies. Force less competitive businesses to compete or allow them to fail. This, it is argued, will make the Canadian economy stronger and more competitive.

The point can be made that, for such a small domestic market, Canadians are trying to produce too much. The Canadian manufacturing sector may be better off if we try to produce less variety, specialize more and improve productivity. Studies show that some Canadian companies are making small quantities of a number of different products. In these cases, the factory is set up to produce one item, then shut down for a period of time to change over to produce another product. Concentration on one type of production would save time, increase economies of scale, lower costs, increase productivity and competitiveness.

Visual 8

SUMMARY OF THE QUANTITATIVE AND QUALITATIVE IMPACTS OF TECHNICAL CHANGE ON EMPLOYMENT IN A NUMBER OF INDUSTRIES

	Agriculture	*Coal mining*	*Textile Machinery*	*Textile Industry*	*Cement Industry*	*Steel Industry*	*Metalworking Industry*	*Computer-aided design*	*Automation*
Reduction in labour force	✓	✓		✓		✓	✓		
Increased output with same or reduced labour force (jobless growth)	✓	✓		✓		✓	✓	✓	✓
De-skilling or making certain skills redundant	✓			✓	✓			✓	✓
Generated the need for new skills	✓	✓	✓	✓	✓		✓	✓	✓
Reduction in job satisfaction									✓
Required higher level management skills	✓	✓	✓	✓	✓		✓	✓	✓
Displacement of specialist skills outside the factory				✓	✓			✓	✓
Job loss due to lack of technical change competitiveness			✓			✓			

Source: R. Rothwell and W. Zeyveld, *Technical Change & Employment,* Francis Pinter, London 1979
Schott, Kerry. **Industrial Innovation in the United Kingdom, Canada and the United States.** London, England: British-North American Committee, 1981.

The impact of technical change upon employment has been studied in several industries in the UK, Canada and the US and the results are summarised in Visual 8. In most industries innovation led to the ability to produce similar levels of output with less people employed. This did not necessarily lead to a reduction in the labour force in the innovating industry since in many cases output expanded and this absorbed the technologically displaced workers. It is notable that in most industries the innovation itself generated a need for new skills amongst the work force and required higher levels of skill amongst management. In the process certain skills became redundant but overall, innovation makes qualitative impacts upon the labour force as well as quantitative ones.

But that's easier said than done. Why?

First, rationalization involves picking winners and losers which is no easy task. Some companies/industries will be regarded as successful, competitive, with good potential. Others are going to be seen as non-competitive. How should the selection process be done?

The problem is that rationalization takes time. It may be that in a few years time (in the *long run*) the adjustment process will work out to be very positive. But in the *short run*, businesses close down and people are put out of work.

This is a key point as far as the role of government in the process of adjustment and rationalization is concerned. In economics, the long run is when major changes take place. New factories are built, new businesses established, new technologies developed, etc. But politicians must be concerned about the short run. If steps taken in the short run have negative consequences, the decision-makers who made those choices may not be around in the long run to see the benefits develop.

The point can be made that the government shouldn't be involved in the process of picking winners and losers. Instead, the **market** should decide. If a company is competitive with other producers, it succeeds. If it isn't, it fails.

TELL US WHAT YOU THINK

Should financial assistance be provided to struggling companies? What criteria should be used to determine successes or failures?

Government has been involved through tariff protection, government grants and so on for a very long time. It is now as large a political decision not to provide these supports as it was to undertake them in the past. In addition, there are differing perspectives on the marketplace and the role of government in it. Some people want government to play a larger role — some argue that it should be less involved.

Again, it comes back to you as a Canadian. What do you think?

The dynamic nature of the Canadian economy — our ability to adjust — is crucial to our ability to compete in world markets. How do we increase our adaptability, our flexibility? How do we rationalize our industries effectively? All of these are key questions facing Canadian businesses, governments, unions and Canadians in general.

Governments face decisions and tradeoffs about whether to assist competitive growing industries or the redevelopment of struggling industries

Protectionist policies can bring retaliation. Both tariff and non-tariff barriers can be used.

■ TARIFFS AND NON-TARIFF BARRIERS

In our discussion of factors affecting Canada's competitiveness, we come once again to tariffs. And at this point we'll consider **non-tariff barriers** to trade.

Tariffs, as we have discussed, can deter trade. Tariffs placed on Canadian goods, by other countries, discourage the export of Canadian products to that country. The tariff, by increasing the price at which the Canadian product would be sold in that country, makes the Canadian product less competitive.

A major reason why countries use tariffs is to protect their own domestic companies. By placing tariffs on imported goods they make imported goods less competitive and domestically produced goods more competitive.

Therefore, the competitiveness of Canadian goods in export markets will depend somewhat on the tariffs other countries place on our goods. This is something that we as Canadians have to keep in mind. If we put tariffs on other countries' goods coming into Canada, why shouldn't they put tariffs on our goods going into their countries. It can develop that countries get into **tariff wars** which can escalate into trade wars, certainly not healthy for world trade.

In terms of competitiveness, tariffs can lower the incentive to be competitive. For example, the landed price (the price of a foreign good that would exist without the tariff) plus the tariff duty equals the price the good will sell for in Canada. This price represents a ceiling price for Canadian producers. There is no pressure then, from foreign goods, to be more competitive and achieve lower prices. In this way, tariffs can reduce our competitiveness.

In addition to tariff barriers — which are highly visible since the specific amount is spelled out and the duty is paid — there are other ways in which countries can discourage foreign goods from entering their markets. These are referred to as non-tariff barriers to trade.

> *The restoration of the old protectionist regime in world trade is still a threat rather than an accomplished fact. But, bit by bit, the barriers to trade are rising again, even if in a different guise, in the form of non-tariff barriers against imports rather than the more visible barrier of high tariff rates.*[15]
> — The Globe and Mail, Toronto

Quotas are an example of a non-tariff barrier. A government may place a quota on the amount of a product that can be imported in any one year. For example, the U.S. could put a quota on the amount of Canadian steel that can be brought into the U.S. This hurts Canadian steelmakers who tend to be very competitive.

A quota can be formal or informal. For example, the U.S. may legislate a specific steel quota. In Canada, we negotiate an informal quota with the Japanese with respect to how many Japanese cars come into Canada each year. It's not written down in law, it is simply discussed with the Japanese and an agreement is reached.

Quotas are just one form of a non-tariff barrier. There are many others. The problem with non-tariff barriers is that they aren't as evident or measureable as tariffs. They are much more varied, and new methods to discourage imports can easily be developed. For these reasons, they seem to be more difficult to regulate internationally than tariffs.

Because they can be tailor-made to any situation, and thus spring up with relative ease, non-tariff barriers are probably the major obstacle we face to easier and more world trade.

Examples of non-tariff barriers other than quotas include the following:

- **Government procurement**. This refers to the government purchase of goods and services from domestic firms even if foreign ones are less expensive. This is a barrier to trade because other nations, no matter how efficient, would not be able to compete. Their goods and services would never be purchased. Because there is so much spending by governments in the world, this can be seen as a major barrier to the international flow of goods and services.

Tariffs protect infant and internationally non-competitive Industries. When should they be used? When not?

- **Embargoes**. A country can simply make it illegal to sell a certain product in that country. For example, Cuban cigars are not available in the U.S. because the government placed an embargo on them. It is against the law for them to be sold in the U.S.
- **Licensing**. It is possible for products from another country to be restricted by special licensing requirements. The license may require that only domestic companies can sell the licensed item. This would prevent the sale of imports altogether. The licenses may be much more expensive for foreign firms than domestic firms. This would give domestic firms an advantage. Governments also are in a position to grant export and import licenses. These influence the companies that will be allowed to export and import.
- **Health, sanitary and labelling regulations**. By placing very strict regulations on foreign goods, governments may prevent or restrict the import of certain items.
- **Customs clearance procedures**. Steps can be taken at customs, when goods enter a country, to slow down their availability for sale. The objective may be to make clearance procedures so slow that foreign companies don't even bother trying to get their goods in for sale.

There are many other forms of non-tariff barriers. If a country wants protection for certain industries a way will be found.

The increased use of non-tariff barriers indicates the importance of negotiations among nations to reduce barriers to trade. As nations stifle trade through non-tariff barriers, gains in reducing tariffs are lost.

If nations around the world are to benefit from the gains of trade, negotiations must continue to ensure a positive environment for world trade.

■ MARKET SIZE

Reference has already been made to the fact that Canada, with a relatively small population, is a relatively small market for sales. When producers sell more, they are able to achieve longer production runs. This enables them to lower the cost for each unit and achieve economies of scale.

Long production runs are one way in which American producers, for example, have a competitive edge over Canadian companies. The U.S. has a population approximately ten times that of Canada. That represents a much larger market and many more potential sales. Companies in the U.S. that do well in the American market can sell more, lower their costs and lower their prices. Therefore, they are potentially more competitive than similar Canadian companies.

To be competitive with other world producers it becomes essential for some Canadian companies to export. If they don't, they cannot sell enough to lower their unit costs and their prices.

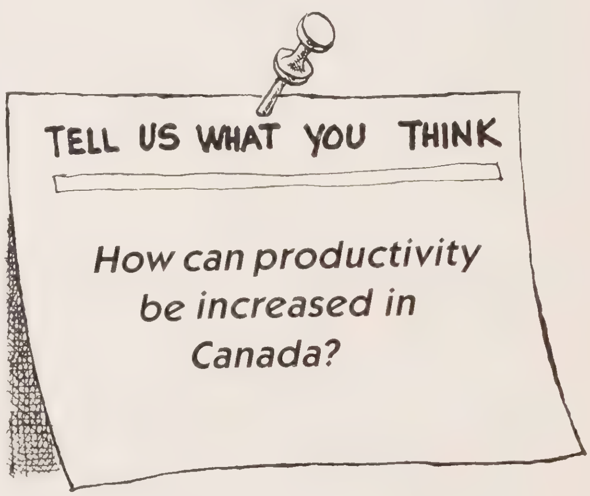
Our small domestic market plays a major role in the competitiveness of some of our companies.

One other point should be mentioned here too. Canada does have a relatively small domestic market. However, the more prosperous Canadians are, the more they can purchase Canadian output. Therefore, the Canadian market becomes more supportive to Canadian business the more prosperous it becomes. Higher real incomes mean opportunities for higher consumption and opportunities for increased savings for investment.

■ THE COMPETITIVENESS OF CANADIANS AS WORKERS/PRODUCERS

> *Our people are just as good as anybody else. . . Our productivity must be improved. . . by making sure that we are able to create a quicker diffusion of emerging technologies through Canadian industries to allow them to become — or to remain — competitive.*[16]
>
> — The Honourable Donald Johnston, M.P.

Canada has a smaller work force than many of the other industrialized countries. This has a number of implications for Canada. There are few Canadians with certain types of specialized training. It may surprise many Canadians to know that even in recent times, workers have been brought into Canada from other countries because there were not sufficient numbers of Canadians trained for the jobs available. This is referred to as a skilled labour shortage. When a company can't hire as much of the labour talent it needs, this can lower productivity and competitiveness.



It is certainly the case that Canada has a relatively well-educated and well-trained working population. The efforts, creativity, research and expertise of Canadians can well match those of the other industrialized countries. As such, many Canadians are relatively well compensated for their efforts. This brings us to a delicate point.

It is rational for all Canadians to seek the highest income they can earn for their talents and expertise. Indeed,

companies follow a similar goal in terms of profit maximization. Unions negotiate on behalf of organized labour in efforts to secure higher incomes for their members. Agents seek the best contracts for hockey players. Stockholders seek the best return when they invest in the stock market. You seek the highest rate of interest when you deposit your money in the bank.

Everyone is interested in improving his/her standard of living. And we live in a society where your standard of living is largely determined by your income and what your income can acquire for you.

Let's repeat that one key line. Your standard of living is determined by your income and what your income can acquire for you. What we have to be careful to avoid is thinking only about the first part — your income, not the second — what your income can acquire.

To understand the distinction, consider the game of Monopoly. In Monopoly you are given a certain amount of money at the outset. You move around the board and buy properties. You then start trading and bidding to acquire sets of properties, form monopolies, build motels and hotels and increase your income until you win the game.

Now, suppose we change the game slightly. Suppose we keep the same number of properties, motels and hotels but we double the amount of money in the game. What will happen? All players will now have twice as much money to spend. When all the properties are purchased and it comes to bidding for properties, each player is probably going to bid a higher price. In fact, it is quite likely that prices will double. So in this game you have twice the initial income — but do you end up better off? The answer is no.

There are the same number of properties, motels and hotels available. You can't acquire any more real wealth than you did in the first game. Your income doubles, prices double but your wealth doesn't increase. All that happens is that the money used in the game is worth less. A property you got in a bidding war in the first game will now be twice the price. Each dollar in the game will be worth half of what it was.

You probably already know, or have figured out, that what is occurring in this second game of Monopoly is inflation. Inflation means money is worth less because we have to use more of it than we did before to acquire the same things. A simple example:

You have $12.00 — Albums cost $4.00
    You can buy 3 Albums
The price rises to $6.00
    You can buy 2 Albums
Your same $12.00 now buys you less.

Canadians want to raise their incomes, but not simply to pay higher prices. We want to increase our standard of living by being able to acquire more with our higher incomes.

What does this have to do with trade and our competitiveness? The answer is, a great deal.

First, if we as Canadians simply seek higher incomes, without producing more in return, we will only generate inflation (higher prices). All Canadians, whether they are seeking higher wages, profits, interest or rents should understand that unless wealth is created (that is, goods and services) in return for the higher incomes, we won't make ourselves better off. We'll only increase the prices we have to pay and make our money worth less.

These higher prices will make Canadian goods less competitive in international markets. The higher the prices of our goods, the fewer we will sell. Hence the fewer we'll need to produce and the more unemployment there will be.

The major point in this discussion is that our standard of living is largely determined by our income and what it can acquire. If we simply seek higher incomes (as profits, interest, wages or rent) without producing more or a better product, we will only generate higher prices, make our products less competitive and lower our standard of living.

Let's look at a few other aspects of the competitiveness of Canadians.

Canadians, as you may have heard, are not generally known as economic risk takers. We tend to be a relatively cautious lot. No one likes to criticize caution but the point is made by some that Canada's competitiveness could be improved if we had a stronger entrepreneurial spirit. In other words, Canada may be more competitive and do better in world markets if we had more like those who started Bombardier — or like those who invented pablum, the zipper, the snowblower, the hydrofoil, newsprint or the Canadarm for the space program — and so on. Perhaps, if we were a little more daring we might develop more new goods and services that would be wanted by the world, increase our exports and bring more money into Canada. It's something to think about.

Another point. As you probably know, strikes and lockouts result when contract negotiations between union and management break down. But when strikes and lockouts occur, people don't work and production is lost. This lowers productivity. As a result, a great number of strikes and lockouts can hurt a country's competitiveness. Table 6 shows how Canada's record compares with that of other countries on this score.

Canada, over recent years, has had the most working days lost through strikes and lockouts than any other industrialized country. This hurts Canadian productivity and competitiveness. The improvement made in 1983 in work days lost to lockouts and strikes could be a big help to our export position.

> *. . . management must be imaginative, adventurous, open-minded and flexible in seeking solutions. The solutions will probably be better, and certainly the commitment to them will be stronger, if employees have a role to play in finding them, and in cooperating and contributing to make them a success. . .*[17]
>
> — Camille A. Dagenais, Chairman, The SNC Group

A cause of even more work days lost in Canada is that of absenteeism. To the extent that improvements can be made in this area, this will also help our competitiveness considerably.

One last point in this area. As well-trained and educated as we are in Canada, any improvements we can make to our training and education programs can only help our competitiveness.

Table 6

DAYS LOST PER THOUSAND EMPLOYEES, 1973-82
(Yearly average)

Italy*	1,211
Canada	914
Australia*	705
Britain	471
United States	396
France*	192
Sweden	133
Japan*	94
West Germany	40

*1973-81

"Now we're tops in strikes" by James Bagnall. **The Financial Post**, August 27, 1983.

DAYS LOST PER THOUSAND EMPLOYEES, 1980-82
(Yearly average)

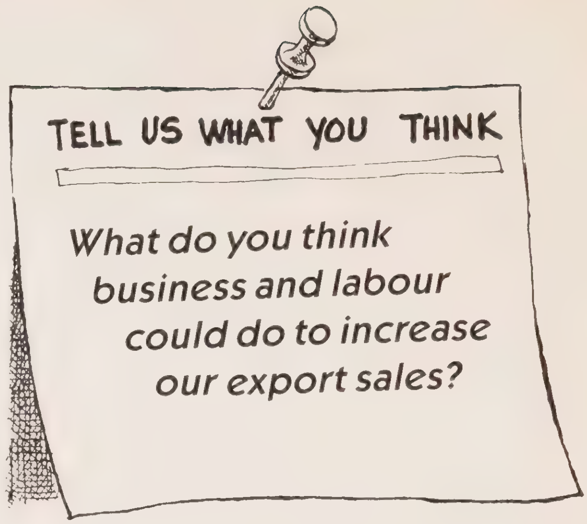
Canada	834
Italy	752
Australia	730
Britain	374
United States	267
West Germany	9

"We can't afford this strike record." **The Financial Post**, August 27, 1983.

Sources of tables: Derived from Strikes & Lockouts, in Canada, 1973-82; Corporations & Labour Unions Returns Act; and U.S. Bureau of Labor Statistics.

The federal Labor Department recently reported that a total of 4.5 million man-days were not worked in 1983 because of lockouts and strikes. That was the lowest level of work stoppages since the 3.3 million man-days recorded in 1977.

Extract from "Strikes and lockouts are lowest since '77" by Virginia Galt. **The Globe and Mail**, **Toronto**, May 14, 1984.



MARKETING SKILLS

Canada's ability to sell products to other countries depends on our marketing skills, that is, how good a job we do at selling our products to others. We need sales agents, trade and market experts, an international sales force and so on.

Canada has historic roots in Europe and we have close relations with the United States. Canadian exporters tend to have a good understanding of those markets — and can deal well with customers. This is particularly true of countries like the U.S. and Britain.

But the most rapidly developing markets are in the Far East — Japan, Singapore, Hong Kong, South Korea. This part of the world is not as familiar to most Canadians. The languages, histories and traditions are quite different.

It will be a challenge for Canadian exporters to develop effective means by which to market Canadian goods in these developing new markets.

THE PERFORMANCE OF BRANCH PLANTS AND MULTINATIONALS

Canadian tariffs on certain goods coming into Canada have historically posed problems for foreign producers who have wanted to sell their products here. Suppose you owned an American company that produced musical synthesizers. The Canadian government put a 25% tariff on musical instruments coming into Canada, forcing the price of your synthesizer up to where it is not competitive in the Canadian market. What do you do?

One option is to build a synthesizer plant in Canada. This is referred to as "jumping over the tariff wall" — and a lot of U.S. and other foreign companies have done such jumping to avoid the cost of the tariff.

A plant set up in Canada, but owned by people outside Canada, is referred to as a branch plant. There are a number of reasons why a branch plant may be set up, but one is to avoid tariffs.

Branch plants are parts of **multinational corporations**. These are companies with offices and plants in various countries around the world.

With respect to Canadian export trade, these branch plants and multinationals have come under some criticism. Some argue that branch plants do not try to sell their products in export markets the same way that domestic companies do. Others counter this by saying that these plants came here to produce for the Canadian market and shouldn't be expected to export. Still others say that branch plants export as much as Canadian-owned companies.

Suppose an American-based multinational has operations in Canada, Mexico, England, Brazil, Saudi Arabia, South Korea and Japan. The Canadian branch may be expected to produce only for the Canadian market and not to produce for export. Should we expect it to? What do you think?

Perhaps in the past branch plants have not been as aggressive at exporting as we might like. But an encouraging development for Canada is **world product mandating**. This means that a multinational company like General Electric will designate that the Canadian plant of the system (Canadian General Electric) will be the only affiliate in the world to produce a particular line of product. Other affiliates can be assigned other lines. In this way, each centre produces a particular product which services a world market. This means that the Canadian operation will be a much more active exporter than if it simply produces the same mix of products that other General Electric plants are producing.

■ ROLE OF GOVERNMENT

Before looking at the ways in which government support can affect our competitiveness and export trade, let's look at the overall role of government relative to trade.

International trade refers to trade between countries. And countries are identified by borders. Borders are a political construction. So, when business is to be conducted which crosses borders, governments become involved.

Governments' role in trade can take a number of forms. For one thing, governments establish protection policies — tariff and non-tariff barriers. Second, governments develop trade policies which include laws, regulations and so forth which govern trade. Third, governments participate in providing assistance to exporters in an effort to improve export trade. Fourth, governments set many other policies which may directly or indirectly affect trade (e.g. tax policies, transportation policies, education policies, communication policies).

A significant role of government in trade is the conduct of Canada's foreign policy, that is, Canada's role in the international environment. The relationship between the Canadian government and, for example, the government of the People's Republic of China can have a great effect on our export opportunities there. The chances of Canadian businesses selling exports to China may be largely affected by whether the two national governments are on good terms or bad terms.

Foreign companies will often "jump a tariff wall" to set up a branch plant

Government can also influence trade through the close relationship between domestic policies and international policies including trade. For example, if a government decides to raise money by significantly raising taxes, prices may rise and reduce our competitiveness. This response would have to be kept in mind when considering the increase in taxes. The key point is that domestic policies need to be developed with one eye to their international consequences.

Let's take a closer look at the role the federal and provincial governments can play in assisting export trade.

Federal Government Support

- **Trade Commission Service:** the federal government maintains a worldwide network of offices to assist companies seeking export markets. There are currently 91 trade offices. Trade Commissioners have a number of responsibilities:

  — introduce Canadian exporters to corresponding business people in other countries

  — study the market conditions and needs of the area of the world in which they are located

  — provide relevant specific and general information to current and potential Canadian exporters (e.g. tariff and trade regulations, other existing competition, etc.)

- **Export Financing:** the federal government assists exporters financially with efforts to break into new export markets. For example, a federal program called PEMD (Program for Export Market Development) will provide up to 50% of the cost incurred in breaking into new markets. The contribution is repayable if sales are achieved.

  Another example is the Export Development Corporation (EDC). This is an enterprise owned by the federal government. Its purpose is to help expand Canadian export trade by providing such aids as credit and investment insurance and long-term loans.

- **Estabishment of International Agreements, Treaties and Pacts:** the Canadian government negotiated, for example, the Auto Pact with the U.S. This pact redefined the trade flows in cars between the two countries and provided assistance to the Canadian auto industry. (For more about the Auto Pact see page 57.)

  The Canadian government also established the Canada-United States Defence Production Sharing Arrangement. Under this agreement the U.S. permits the duty-free entry of most military products from Canada into the U.S. This was an exception to the "Buy America Act" which required the U.S. Defence Department to purchase U.S.-made defence equipment.

  If free trade or sectoral free trade is established with the U.S. or any other country, the government will be the chief negotiator.

- **Foreign Marketing:** there are many ways in which the federal government assists with marketing Canada's exports in other countries. These can include trade shows, visits by Trade Ministers, embassy assistance and so on. An example is the Promotional Project Program (PPP) which plans and implements trade fairs abroad and co-ordinates trade visits by foreign buyers to Canada.

  In the agricultural area, the federal government provides assistance through marketing boards (e.g. wheat marketing board, egg marketing board, etc.). These marketing boards aim to establish trade contracts for Canadian agricultural products in foreign markets. It would be difficult for a single farmer from Alberta or Saskatchewan to find someone in the Soviet Union to buy his/her wheat. But the marketing board, through the federal government, can arrange a purchase of Canadian wheat by the Soviet government. Canadian farmers will then produce and sell the wheat to complete the deal.

  Assistance with the marketing of Canadian exports in other countries is a major role that the federal government can play.

- **CIDA (Canadian International Development Agency):** this is a federal agency responsible for the administration of Canada's development-assistance program or **foreign aid** program. CIDA deals with the developing countries. CIDA will, in some cases, provide loans or financial assistance to developing countries, sometimes providing the money to be used to purchase necessary items from Canadian companies (**tied aid**).

  An objective of CIDA is to encourage economic and social growth in the developing countries. On the economic side, if these countries prosper, they will represent new, expanding markets for Canada.

- **Intermediary with Other Governments:** many export deals are negotiated with governments. The Canadian Commercial Corporation (CCC) aims to assist Canadian firms in obtaining foreign government contracts. Government-to-government trade is an expanding area of world trade.

- **Promote and Assist Research and Development:** the federal government through spending and tax policies can assist, promote and undertake research and development. The aim is to develop improved technology and methods in Canada to help us become more competitive internationally.

Provincial Government Support

The provincial governments offer services and programs that for the most part complement the federal programs. They also offer funds to Canadian exporters for trade fairs and promotion of exports. In addition, some provinces such as Quebec, Ontario, Alberta and British Columbia, maintain international offices abroad to help develop export markets.

An illustrative list of services and programs offered by the provinces follows:

Newfoundland:	Market and Product Development Program
Prince Edward Island:	Market Development Centre
Nova Scotia:	Marketing Assistance Program
New Brunswick:	Commerce and Industry Service Branch, Department of Commerce and Development
Quebec:	Aide à la Promotion des Exports (APEX)
Ontario:	Trade Development Branch, Ministry of Industry and Tourism
Manitoba:	Promotion Assistance Program
Saskatchewan:	Aid to Trade Program
Alberta:	Trade Development Branch, Department of Business Division
British Columbia:	Trade Show Assistance Program Market Development Assistance Program Trade Division Program Incoming Buyers Program

FEDERAL-PROVINCIAL RELATIONS

As the previous discussion has indicated, both the federal and provincial governments are involved in efforts to increase export trade. Certain matters affecting exports and exporting companies come under the jurisdiction of the federal government. Other matters are the concerns of the provincial governments. And there are still other areas in which both levels of governments are involved. Because of the overlap between governments in the trade sphere, our export success can be affected by how well various government programs are co-ordinated — or how they conflict.

The federal and provincial governments interact on many issues. The interaction of the federal and provincial government is referred to as federal-provincial relations. When relations are good, and decisions are co-ordinated, policies are implemented more effectively.

On the other hand, if the two levels of government disagree, have different priorities or are unaware of each others' actions, policies can duplicate or counteract one another.

Export trade is no exception to this. Our trade efforts are assisted when the policies of the federal and provincial governments complement each other and have similar objectives.

In the area of trade, federal-provincial relations are particularly relevant when it comes to such areas as: taxation, government procurement, resource ownership and marketing boards. There is a need for effective co-operation in support of technological advancement, and financial and research assistance to current and potential exporters.

Consider, for a moment, a ten team National Hockey League (NHL). Imagine that there are five very strong teams and five very weak teams. What would be the likely outcome of this situation? It would probably be a poor league. Many games would be uninteresting because of the lack of balance. Competition would be weak and players would not have to play their best. Fans would drift away.

If you read the sports pages you have probably noticed that even the strong teams are pleased when weaker teams improve. It means that the quality of play will improve and more fans will come to the games. The good teams will have to play even better and, overall, the league is much better off.

It's not so farfetched to compare Canada to this imaginary hockey league. As a country of ten provinces and two territories, we are stronger when all regions are performing well, competing well and putting pressure on each other to be better.

Balance, equity and fairness are three very important factors, with twelve different areas making up our country. For the federal government, it is essential to balance the interests of the different regions of Canada when developing policies. Policies must be developed so that overall some areas of the country are not favoured over others. This is difficult given the vast regional variations in Canada.

Provinces and territories differ in terms of perspective and priorities for a number of reasons: regions are at different levels of economic development; resource endowments vary in type, quantity and quality; transportation modes and costs vary; types of industries vary; major trade partners are different, and so on.

For the **European Economic Community** (EEC) the major exporter is Quebec — about 30% of our exports to the EEC come from that province. Over 50% of our exports to Japan are shipped from the Pacific region of Canada.

Given these differences in trade patterns, policies aimed at changing our relationship with Japan, for example, do not affect all regions of Canada equally. The same is true for policies affecting any of our other trading partners such as the EEC and the U.S. Our foreign and domestic policies must take these variations into consideration. The important thing is that, over time and over many policies and actions, balance must be achieved.

Long-term overall balance depends on effective consultation among the federal government and the provinces. The federal government has to be aware of and sensitive to issues and programs in each region. In turn, each region has to be sensitive to the other regions and to the federal efforts to achieve balance for all areas.

This objective of balance is difficult to achieve for other reasons besides the variations mentioned previously. Provinces and regions vary in terms of population, electoral strength, financial strength and so on.

What are some of the general priorities of the provinces on trade matters? All provinces agree on the need to work aggressively to open up new foreign markets to Canadian producers. They believe it is important for the governments to work together to help firms break into new markets. They also agree on the need to support new, innovative smaller firms with growth and export potential.

The provinces generally support the move toward freer trade through tariff reduction. This idea, however, is often discussed as *free and fair trade* illustrating the concern of some provinces for their fair share of the benefits.

All provinces tend to agree that the U.S. will remain our major trading partner. Therefore, they all encourage the development of good trade relations and react negatively to any move to protectionism in the U.S.

There is also general agreement to work towards the reduction/elimination of non-tariff barriers which are increasing around the world.

Another area of agreement is in terms of federal financial support of exporting firms. It is felt that support should be given with discretion and equity throughout the various regions of Canada.

Foreign investment is generally regarded as necessary to help strengthen the Canadian economy and Canadian firms. This is particularly important to provinces with smaller financial bases such as Newfoundland.

There is also general agreement on the importance of governments working in co-operation with the private sector to expand export trade.

The provinces also agree on the importance of achieving further processing of our resources, where possible, prior to export. Saskatchewan, for example, exports about 90% of its products in raw, unprocessed form. It would like to reduce this proportion. Other provinces have similar objectives.

All provinces are also in favour of expanded service trade although there are differences in the preferences among service areas to be encouraged.

These areas of agreement illustrate that even though there are twelve areas making up our country, harmony is possible. The federal government must be effective in its leadership role to generate consensus, co-ordination and co-operation. There will be differences and there will be conflicts. But there are great opportunities for success and the simultaneous achievement of both expanded export trade and balanced impact on the various regions of the country. This objective is crucial to our trade future.

INTERPROVINCIAL TRADE AND TRADE BARRIERS

Trade occurs across international borders. It also occurs across provincial borders. As a nation we seek to expand our export trade. Provinces and regions, too, are looking to increase trade and achieve the benefits from trade sales. Not only do they seek international trade but also trade within Canada.

Early in Canada's history, policies (such as the **National Policy**) were developed to try and increase trade among the various provinces and regions of Canada. Today there is a great deal of trade that flows between regions of Canada.

In the same way that increased export sales help a company in terms of efficiency, increased domestic sales can also help a company. This means, of course, that Canadian companies compete with each other for shares of the domestic market. This leads, naturally, to companies in one region competing with companies in another region. This is a concern to the provinces.

Why? Employment is the major reason. For example, suppose an Alberta firm produces a product more cheaply than a B.C. firm. If the Alberta firm can sell that product more cheaply in B.C., the B.C. firm will lose business. That represents a loss of revenue for the firm. It can also lead to lay offs and higher unemployment in B.C. That can lead to higher welfare costs, etc., for the B.C. government. It also can mean a loss of tax revenue from the lost employees' income and the lost business income. The provincial governments can become very concerned about out-of-province competition to the firms in their province.

The result of this is similar to the international trading world. Provinces have established **interprovincial trade barriers** in some cases to restrict the local sale of certain products from other parts of Canada.

There are great concerns over these barriers to trade. In the same way that people are concerned about barriers to world trade, people are concerned about the increase in these interprovincial barriers.

Many of the reasons for concern are similar to the international trade concerns: decrease in competition, decrease in productivity, protection of inefficiency, risk of reciprocal action and trade wars, deterioration in provincial relations and so on.

Let's take a look at some of the barriers to **interprovincial trade** which are generating so much concern.

You might wonder how one province can prevent the sale of goods from another area of Canada. The borders are open. A truck can drive right across without stopping at customs.

Let's look at this trucking example first. Provinces regulate the weights allowed on provincial roads. A load carried over one province may be judged too heavy when it comes to the weigh station in the next province. The provinces can also stipulate that truckers have to have special licences to truck goods into or through the province. Through these types of regulations, a province can slow down or prevent some goods from being trucked in from other areas.

Consider another example: the pricing policies for alcoholic beverages. Some provinces put larger markups on alcoholic beverages from other provinces than on those from their own provincial producers. This discourages the sale of some out-of-province liquors.

Agricultural policies can be used as a barrier to interprovincial trade. One province might require a special permit to sell milk. That permit may be unavailable to an out-of-province producer who may be producing cheaper milk.

A province may require milk to be inspected by provincial inspectors prior to sale. If these inspectors don't travel out of province then out-of-province milk can't be sold there.

Natural resource policies can block the flow of goods. A province may charge a duty on ores shipped out of the province for processing. This encourages the processing of the ores in the provinces where they are mined.

Purchasing policies of the provincial/territorial governments can prevent trade from other regions of the country. One provincial government may make a rule that all provincial government purchases must, to the maximum extent possible, be made from provincial companies. This is referred to as government procurement policy. This certainly discourages the purchase of out-of-province goods.

There can also be barriers to the movement of resources such as capital and labour. A province may adopt a policy requiring companies to give first priority to provincial workers. Only if they can't find a provincial worker for the job, can they hire an out-of-province employee.

Perhaps these provincial barriers to trade are understandable. But, there is growing concern that expanding barriers will not be good for Canada. They inhibit the free flow of goods and can damage interprovincial relations. Perhaps Canada needs to ensure interprovincial trade is conducted under a set of consistent, fair and stable rules. In any case, the issue of interprovincial trade is a major one for all provinces to address.

CHAPTER VII

A LOOK AT CANADA'S TRADE HISTORY

Undoubtedly you've heard of the first adventurers who, in their explorations, were either looking for new lands in general or "bumped into" Canada on the way to looking for a quick route to China. These daring individuals serve well to show how important trade has been, and is, to Canada. It was often the search for trade and trading routes that took these explorers out on their voyages.

Even if China was what they were looking for, and Canada was what they found, the explorers and early traders did find things of value. They found timber and fish and furs. All of these commodities had a market in Europe.

Right from the outset, Canada exported predominantly resources. And it was primarily trade with Europe. Canada was largely settled by Europeans. With their roots in Europe, they naturally maintained ties there, including economic ties. Besides, in the early days, the American colonies were a small market compared to Europe.

Most of you are familiar with the struggle between France and England for predominance in Canada — Wolfe, Montcalm, the Plains of Abraham. The result was that Canada came under British rule and was part of the British Empire.

As part of the British Empire, Canada enjoyed preferential trade privileges with Britain and other countries of the Empire. This helped Canada in the early days because it meant Canadian products had preferential treatment in a large world market.

Canada's early trade then, was largely with Europe and was mostly in natural resources. This continued until the mid-1800s when Canada was suddenly denied the preferential trade privileges with Britain after Britain adopted free trade. As a result, Canadian trade shifted direction — towards the United States. Trade with the U.S. in the mid-1800s was based on a **Reciprocity** Treaty that allowed for the free flow of goods between the two countries. The rapidly growing U.S. market was a key target for Canadian exporters.

But in 1866 the U.S. abandoned the Reciprocity Treaty with Canada and established tariffs to protect U.S. producers from Canadian products. This was another serious blow to Canada — another major world market was suddenly more difficult to sell in, this time because of tariff barriers.

Canada attempted to restore free trading relations with the U.S. Four delegations of Canadians over a period of about seven years went to Washington to try and renegotiate free trade. They were unsuccessful.

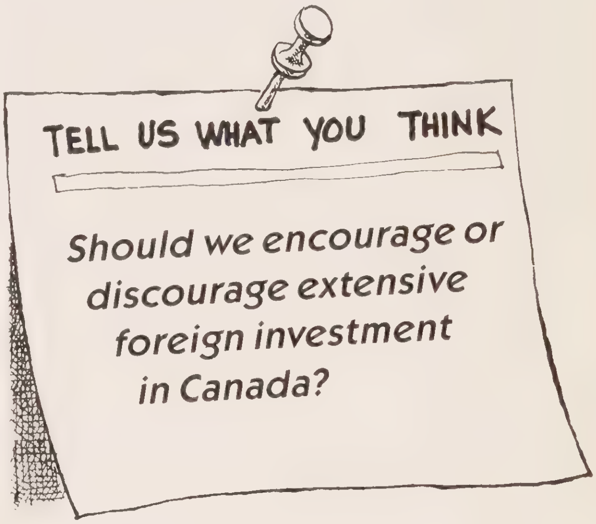
Around 1873, a general world-wide recession (if not a full depression) began. Canadian producers were dealt a third blow. They had lost preferential trade with Britain and free trade with the U.S. Now sales were further hurt by recession. It was in this climate that Sir John A. Macdonald and his Conservative government introduced the National Policy tariff in 1879.

A component of the National Policy put up tariff walls to protect Canadian producers. The aim was to enable the development and expansion of Canadian manufacturing by providing a fairly secure domestic market. Accompanying the tariff protection was an active policy to increase immigration to Canada — again to help increase the domestic market and expand production capabilities.

The National Policy had other objectives, too. It sought to increase east-west trade in Canada rather than north-south trade with the U.S. In this way it was hoped that the National Policy would tie regions of Canada more closely together.

Another objective was to attract foreign investment into Canada. Foreign producers, who before the National Policy could sell their goods in Canada without tariffs, found that their prices were forced up by the new tariffs. Their goods couldn't compete with Canadian producers at these prices.

The answer for many was to "jump the tariff wall" and establish branch plants in Canada to produce for the Canadian market. In this way, Canada received a substantial amount of foreign investment which meant spending for production, higher employment and higher incomes.



The National Policy, with its aim to open the West, increase east-west trade and expand immigration, led to a rapid expansion of western settlement and, subsequently, the wheat boom.

In the latter part of the 19th century and early 20th century, wheat became a major export for Canada. Markets throughout the world were expanding, Canadian production was expanding and Canadian sales were expanding. The wheat production of the West brought new incomes and employment to Canadians.

As world markets for western wheat opened up, there was some renewed interest in exploring free trade with the U.S. Western farmers were certainly in favour of it as were the Maritime fisheries. Sir Wilfred Laurier, in the election of 1911, ran on a platform of seeking freer trade with the U.S.

What Laurier and the Liberals hadn't counted on was how nervous central Canadian manufacturers were about free trade with the U.S. They had developed and grown behind a protective tariff wall and they suddenly felt threatened by the prospect of foreign competition.

The result was that Laurier lost the election of 1911 to the Conservatives who ran on a platform of continued tariff protection.

After the First World War, there were a number of changes to Canada's trade. For one thing, manufacturing developed significantly, particularly in Central Canada. Second, Canada's economic ties with the U.S. strengthened while they weakened with Europe.

The Depression of the 1930s generated what you might expect. In troubled economic times, countries tended to increase protection of their domestic producers. This put a further damper on world trade and probably made the effects of the Depression more severe.

Most readers will probably be familiar with written accounts of the severe hardship of the Depression. Spending declined dramatically. Production fell off. People lost their jobs and couldn't find new ones. Adding to the hardship was the severe drought which plagued western farmers. And, of course, the Depression was world-wide.

It was in this kind of environment that governments looked for ways to increase production and create employment. What could be done? Push to expand export sales? That didn't look hopeful in the 1930s. Or establish protective tariffs to encourage citizens to buy domestic products? The protectionist route was the one many countries adopted. Whether it was right or wrong can be debated. But it is interesting to note that during the recession of the early 1980s, many countries campaigned to prevent a threatened return to protectionism. It seems that the pendulum may have swung towards a preference for keeping trade doors open during difficult economic times. Anyway, let's get back to the '30s and '40s.

The Second World War kicked North America's production machinery back into gear. It also had the effect of devastating Europe. Those countries became markets for Canadian and U.S. goods when the time for rebuilding arrived.

But renewing economies tended to seek protection, too, and world trade and economic development became sluggish.

It was in this environment that a number of countries came together to negotiate ways to reduce barriers to world trade. They signed a treaty called GATT — the **General Agreement on Tariffs and Trade**.

Table 7

VALUE OF FOREIGN TRADE, SELECTED YEARS, FROM 1886
(in millions of dollars)

Year	Imports from U.K.	Imports from U.S.	Imports Total	Exports to U.K.	Exports to U.S.	Exports Total	Balance of Trade
1886	39	43	96	37	34	85	−11
1896	33	54	105	63	38	116	+11
1906	69	169	284	127	84	247	−37
1916	77	371	508	452	201	742	+234
1921	214	856	1,240	313	542	1,189	−51
1929	195	894	1,299	290	523	1,182	−117
1931	110	394	628	172	257	605	−23
1939	114	497	751	329	390	936	+185
1946	138	1,387	1,842	596	905	2,299	+457
1948	294	1,799	2,618	685	1,520	3,087	+1245
1950	401	2,090	3,125	471	2,050	3,143	+18
1954	382	2,871	3,968	656	2,359	3,926	−42
1956	481	4,041	5,566	817	2,866	4,839	−727
1960	589	3,689	5,495	925	3,039	5,390	−105
1961	620	3,870	5,718	923	3,217	5,903	+185
1975	1,222	23,616	34,691	1,777	21,074	32,466	−2225
1977	1,279	29,815	42,332	1,929	30,404	43,684	+1352
1978	1,609	35,436	50,102	1,985	36,651	52,259	+2152
1979	1,928	45,571	62,871	2,589	43,519	64,317	+1446
1980	1,974	48,473	69,128	3,187	46,828	74,259	+5131
1981	2,234	54,131	78,665	3,321	53,667	80,895	+2230
1982	1,904	47,866	67,856	2,727	57,685	84,530	+16674
1983	1,810	54,103	75,587	2,509	66,333	90,964	+15377

Export Canada, the Marketing Directory for Canadian Trade. Surrey, B.C.: CanExpo Publishers, 1983; Statistics Canada. **Canadian Statistical Review.** Monthly. Catalogue no. 11-003.

According to Table 7, when did Canada seem to make a significant shift to trade with the U.S. rather than the U.K.? Why do you think this was such a turning point?

GATT is discussed more fully shortly but, in general, its purpose is to bring participating nations together periodically to negotiate means to reduce trade barriers and increase world trade.

Canada was one of the early enthusiasts for the GATT treaty. We have been an active member and supporter of the on-going negotiations. Through participation in GATT, Canada is committed to a progessive reduction of protectionist policies as are all the other nations involved in the GATT discussions.

As our economy expands, as world markets such as the Pacific Rim expand, as GATT negotiations proceed and further world developments occur, Canada is faced with many choices, decisions and options. One decision to be made is where to focus our efforts for developing our trade partnerships and relations. In the next chapter we will look at these trade options.

IMPORTANT DATES IN CANADA'S TRADE HISTORY

1846	British adoption of free trade brings an end to Canada's privileged position with Great Britain's old Colonial system of tariff preferences and shipping markets. British-American merchants seek to obtain comparable preferential treatment with the United States.
1854	Reciprocity Treaty negotiated. Colonies that will form Confederation enjoy free trade with the United States in certain natural resource and agricultural products.
1866-1876	Canada seeks better terms of access to both United States and British markets, with disappointing results.
1873	World-wide depression.
1879	Sir John A. Macdonald's National Policy — Canada adopts a high tariff policy, as did most trading countries. Canada unsuccessfully tries to convince Britain to discriminate against non-Commonwealth sources.
1892	Founding of the Trade Commissioner Service.
1897	Canada grants British goods preferential access, which later becomes the system of Commonwealth preferences. Britain does not reciprocate, and because Canada's trade with emerging trade partners was previously negotiated by Britain for Canada, countries such as Germany retaliate against the British preferential access by imposing a maximum tariff on Canadian goods.
1907	Canada adopts a tariff structure that provides for three levels of duty: • the British preferential tariff, enjoyed by British and Commonwealth goods, which has the lowest rates • the intermediate tariff, with rates lower than the general tariff, which could be extended to any country by order-in-council • the general tariff, which has the highest rates, applied mainly to imports from the United States, even though the United States is fast becoming Canada's best customer.
1910	A renewed effort to obtain reciprocity with the United States results in a trade agreement similar to the one in 1854 but is rejected in the Canadian election of 1911.
1919	Britain gradually retreats from its adherence to free trade by selectively introducing preferences favouring Commonwealth countries.
1920s	Canada continues negotiations with non-Commonwealth countries, notably France, offering access to the Canadian intermediate tariff in exchange for most-favoured nation (MFN) status or similar treatment by the other party.
1930s	World-wide depression.
1930	Smoot-Hawley Tariff in the United States brings in large tariff increases and other barriers to trade. Britain follows suit with other Commonwealth members at a trade conference in Ottawa in 1932.
1934	The United States introduces the Reciprocal Trade Agreements Act and enters into most-favoured nation (MFN) agreements through a series of bilateral trade negotiations. A limited Canada-U.S. agreement is concluded in 1935.
1937-1938	In return for U.S. tariff reductions, Canada and Britain further reduce their tariffs to the United States in exchange for access to the U.S. MFN rate and concessions affecting some principal Canadian exports. For the first time since 1866, Canada-U.S. trade is fully restored to MFN status with the exception that Canada retains its Commonwealth preferences.

1948	The disruptions of the world trading system in the 1930s and 1940s leads to the creation of a new world trading order as espoused by the General Agreement on Tariffs and Trade (GATT). Canada is a major participant.
1950s	Priority is given to reducing foreign barriers to Canadian exports of industrial materials, foodstuffs, and selected manufactured goods, while making reciprocal reductions in selected tariff protected Canadian secondary industries.
1960s	Canada gives high priority to obtaining improved access for fully manufactured products while protection given to secondary industries in Canada is gradually reduced. Multilateral trade liberalization through successive GATT negotiations is supplemented by two important bilateral deals with the United States: the Automotive Products Trade Agreement and, to a lesser extent, the Defence Production Sharing Arrangements. Commonwealth preferences diminish in importance.
1970s	Bilateral non-preferential trade and economic cooperation agreements are concluded with the European Community (EC) and with a number of other countries. The Tokyo Round of GATT talks produces large decreases in global tariff barriers.
1980s	As a result of the Tokyo Round, tariffs continue to decrease. Use of non-tariff barriers are on the rise. With increasing Canadian exports to the United States, debate heats up on Canada-U.S. free trade proposals and other trade options for Canada.

CHAPTER VIII

CANADA'S TRADE PARTNERS – THE OPTIONS

Where do we look for Canada's most favourable trade opportunities?

In trying to achieve export sales, companies may work out deals with foreign buyers directly — producer to purchaser. But governments may enter the picture in a number of ways. Two significant ways are by assisting companies with marketing their products and negotiating trading partnerships with another country or group of countries which provides a trade advantage to producers.

Throughout the world, a number of trading blocs or pacts have been formed. Member countries agree to give each other special trade privileges.

The European Economic Community (EEC) is an example of such a trading pact. The term often used for the EEC is the European Common Market. Ten European countries have joined into a common market in which goods move freely to and from each other. As well, common tariffs are placed on some goods and services from non-EEC countries.

The countries which are members of the EEC are shown on Visual 9. On the same Visual, other trade groups are shown.

In all of these cases, the countries which are part of the group enjoy special trade privileges over non-member countries.

You will note that Canada is not a member of any of these groups. The Canadian government arranges trade deals on a case-by-case basis with other countries. But, at this point, Canada is not a member of a formal trading bloc.

One suggestion has been for Canada, the U.S. and Mexico to form a North American Common Market operating similarly to the EEC. Under such an arrangement, goods and services would flow among the three countries without tariff barriers. Another suggestion has been for the countries of North America and the Pacific Rim to form some type of trading pact. So far, these have developed into little more than ideas.

Trading blocs can help the countries which are members. But they can present problems, too. Membership can cause a country to lose some independence in that the countries of the bloc may have to participate in economic discussions with other countries as a group — not individually.

Furthermore, if trading blocs give member countries special trade privileges, they also put non-member countries in a position of disadvantage. These countries may reciprocate and make it difficult for goods from the bloc countries to be sold within their borders.

There are pros and cons to entering into such formal trade partnerships. Canada will likely face decisions in the future regarding whether or not to join some pact. At that time, the pros and cons will have to be carefully weighed.

There are three major ways in which groups of countries can organize themselves to offer preferential treatment to each other and discriminate against non-member countries:

- **A Free Trade Area:** this consists of a group of countries which has eliminated all tariff barriers among themselves. However, they do maintain their own individual tariffs placed on the imports from non-member countries.

  An example of this type of arrangement is the European Free Trade Association (EFTA).

Visual 9

MAJOR WORLD TRADING BLOCS

ANCOM:	Andean Subregional Group *Members:* Bolivia, Colombia, Ecuador, Peru, Venezuela
ASEAN:	Association of South East Asian Nations *Members:* Indonesia, Malaysia, Philippines, Singapore, Thailand
BENELUX:	Belgium-Netherlands-Luxembourg *Members:* Belgium, Netherlands, Luxembourg
CACM:	Central American Common Market *Members:* Costa Rica, El Salvador, Guatemala, Honduras, Nicaragua
CARICOM:	Caribbean Community *Members:* Antigua, Barbados, Belize, Dominica, Grenada, Guyana, Jamaica, Montserrat, St. Kitts-Nevis-Anguilla, St. Lucia, St. Vincent-Grenadines, Trinidad-Tobago *Associate Member:* Bahamas
ECOWAS:	Economic Community of West African States *Members:* Benin, Cape Verde, Gambia, Ghana, Guinea, Guinea-Bissau, Ivory Coast, Liberia, Mali, Mauritania, Niger, Nigeria, Senegal, Sierra Leone, Togo, Upper Volta
EEC	European Economic Community (Common Market) *Members:* Belgium, Denmark, France, Federal Republic of Germany, Greece, Ireland, Italy, Luxembourg, Netherlands, United Kingdom
EFTA:	European Free Trade Association *Members:* Austria, Iceland, Norway, Portugal, Sweden, Switzerland *Associate Member:* Finland
LAFTA:	Latin American Free Trade Association *Members:* Argentina, Bolivia, Brazil, Chile, Columbia, Ecuador, Mexico, Paraguay, Peru, Uruguay, Venezuela

- **A Customs Union:** this type of organization is different from a free trade area in that there is a common tariff applied by all members to imports from non-member countries.
- **A Common Market:** this type of organization goes one step further than the customs union. As in a customs union, there is free movement of products among member nations (no tariffs). But there is also free movement of all factors of production (for example, capital and labour).

  The common market represents the most complete form of economic union between or among countries.

  Although referred to as a common market, the European Economic Community is really a customs union, with ambitions to be a full common market.

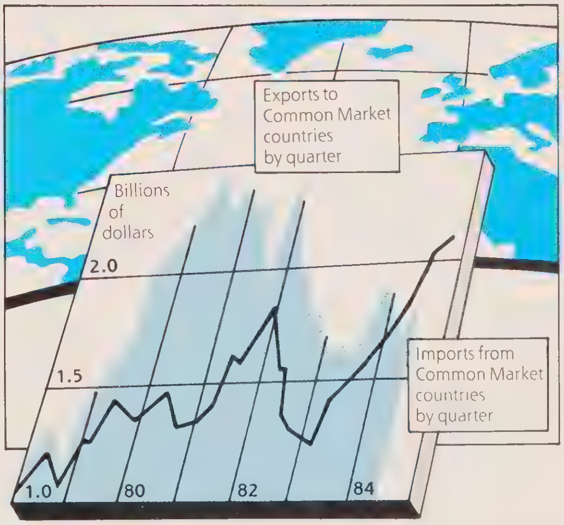
Canadian exporters obviously want to put the bulk of their efforts into selling to those areas of the world where we are likely to have success. Let's take a look at the major options facing Canada.

■ Europe

Canada has close historical ties to Europe. Many Canadians either came from Europe or are the descendents of those who did. We have strong historical connections to Britain and to France. Many Canadians fought in Europe during the two World Wars. And Europe is a popular travel destination for Canadians.

Visual 10

CANADA'S TRADE WITH THE COMMON MARKET



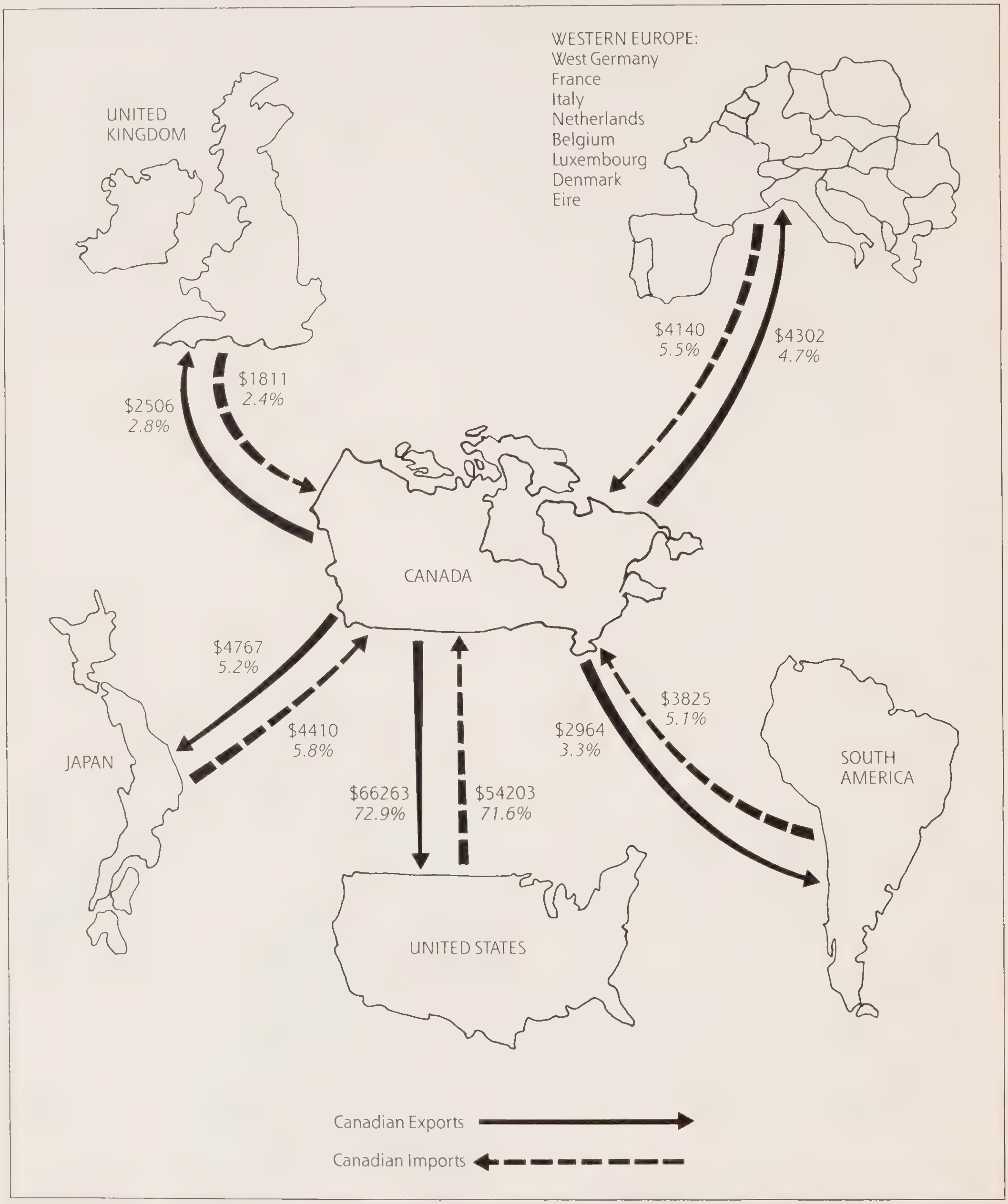
Cansim-Telechart

Changing balance: Canada now imports substantially more than it exports from European countries — $2.1 billion in imports for this year's second quarter compared with $1.8 billion in exports.

"Our European buys outstrip sales there" by Ann Auman. **The Toronto Star**, August 23, 1984.

Visual 11

CANADA'S MERCHANDISE IMPORTS AND EXPORTS — 1983
(in millions of dollars)



Source: Statistics Canada, **Summary of External Trade,** 65-001.

Thexton, James. **Made in Canada, Economics for Canadians**. Toronto: Oxford University Press, 1981.

Table 8

CANADA'S EXPORTS BY DESTINATION
Excludes re-exports

	1983 $ million	1983 vs 1973 % change
U.S.	64,461	+287%
Japan	4,734	+162%
Britain	2,446	+54%
Soviet Union	1,762	+506%
China	1,605	+487%
West Germany	1,156	+162%
Netherlands	953	+239%
Belgium/Luxembourg	696	+146%
France	627	+197%
Brazil	598	+420%
South Korea	555	+789%
Italy	546	+86%
Algeria	448	+1,529%
Australia	438	+105%
Mexico	375	+216%
Other	7,026	+225%
TOTAL (Customs basis)	88,426	+256%

"Enormous strides made in trade over a decade." **The Financial Post**, March 31, 1984.

According to Table 8, to which country have our exports expanded the most since 1973? Can you explain why this has been the case? Which countries appearing on this Table as major destinations for our exports do not appear on Table 9 as a major source of imports? Why?

Table 9

SOURCE OF CANADA'S IMPORTS

	1983 $ million	1983 vs 1973 % change
U.S.	54,203	+228%
Japan	4,410	+336%
Britain	1,811	+80%
West Germany	1,576	+160%
Mexico	1,079	+1,196%
Venezuela	1,014	+94%
Taiwan	926	+465%
France	841	+157%
Hong Kong	821	+647%
Italy	798	+225%
South Korea	791	+774%
Iran	527	+300%
Brazil	499	+473%
Sweden	416	+150%
Switzerland	409	+247%
Other	5,573	+158%
TOTAL (Customs basis)	75,694	+225%

"Enormous strides made in trade over a decade." **The Financial Post,** March 31, 1984.

According to Table 9, from which country have our imports expanded the most from 1973 to 1983? Can you explain why there has been such rapid growth in imports from this country. From which country have our imports grown the least? Why? From the information given, calculate the value of our imports from Japan in 1973.

Canada has close *economic* ties with Europe as well. But does our trade future lie with Europe?

Canada continues to be a member of the British Commonwealth but we no longer enjoy special trade relations with Britain. This is particularly true since Britain joined Europe's common market and became an official member of the EEC (European Economic Community). Goods and services tend to flow between European countries without tariff barriers (some non-tariff barriers are still used). Canada is not a member of the EEC. Therefore it is difficult, and becoming more difficult, for Canada to make gains in export trade in Europe.

> *Canada's relationship with the European Economic Community might be compared with an old but well-made suit — not flashy but comfortable. . . [W]hile the EEC will remain an important trading partner, it will be one of diminishing importance in Canada's over-all trade picture. . . Despite* [*difficulties in the relationship*]*, Canadian companies have achieved some success in recent years in penetrating the European market for products such as telecommunications and office equipment, vehicles and parts and machinery.*[18]
> — The Globe and Mail, Toronto

Canada still exports to Europe, as Visual 10 shows. Because of the existence of the EEC, the potential for exporting to Europe will probably shrink. Specific opportunities will arise. But given opportunities that exist elsewhere, it is unlikely Europe will be the major focus of Canadian efforts to expand export sales.

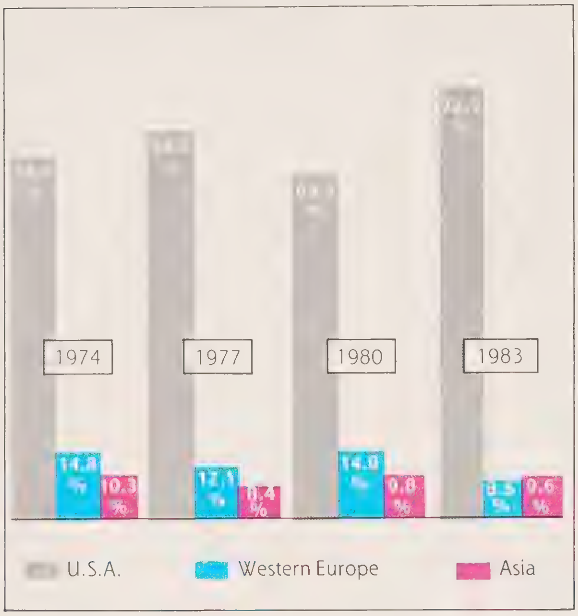
■ The Pacific Rim

The fastest growing economic area in the world is the **Pacific Rim**. Pacific Rim countries include Japan, South Korea, Singapore, Hong Kong. Refer to the glossary for a list of other Pacific Rim countries. This area of the world holds great opportunity for Canada.

> *In combination, the extraordinary Japanese performance, the emergence of new major exporting countries (South Korea, Taiwan, Hong Kong and Singapore), and evidence of similar (though as yet fairly localized) industrial growth in other nations of Southeast Asia (Malaysia, the Phillipines, Indonesia, and Thailand) have encouraged the view that, in the twenty-first century, the Pacific Rim could well be a focus of economic activity and trade comparable to the North Atlantic basin.*[19]
> — Economic Council of Canada

Visual 12

EXPORTS TO MAJOR CUSTOMERS AS PERCENTAGE OF TOTAL



Source: Statistics Canada.

"Boom in Pacific Rim rocking our economy." **The Toronto Star**, May 7, 1984.

But, there are a number of challenges involved. Language tends to be unfamiliar. Ways of doing business are often different. However, Canadians are learning how to conduct trade negotiations with Pacific Rim countries.

Another factor to consider is the stiff competition we face from this part of the world. Japan is a dominant economic force. It has distinct advantages over Canada and the U.S. when it comes to trade in this part of the world and elsewhere. It may be possible for Canada to increase exports to this part of the world but it will be a "tough nut to crack".

As well, Canada's trade services are not as well developed in that part of the world as they are in Europe and the U.S. To set up offices and make connections is essential if we want to do business in the Orient. However, building relationships takes time and the pay-off to this investment may well lie in the future.

In conclusion, Canada cannot afford to ignore the developing Pacific Rim. It promises increasing opportunities for us to expand our export sales. It would be to Canada's advantage to pursue aggressively, and quickly, our trade opportunities there. Government trade offices can be opened. Canadian businesses can establish offices and develop contacts. Canadian exporters can learn more about this part of the world — the traditions, the languages, the attitudes, the preferences. And we can develop healthier trade partnerships with countries of the Pacific Rim.

■ The United States

The U.S. is, by far, Canada's largest trading partner. Well over 70% of our exports are sold in the U.S. Why?

Many of the reasons are quite evident. The U.S. is our closest neighbour. It costs less to transport goods and services to the U.S. than to anywhere else. Our two countries overlap in language. We have similar consumer tastes and preferences. This means producers here can produce the same products for both markets.

The U.S. is also more than just a close neighbour. Our border relationship is one of the most friendly in the entire world. It's understandable that we should trade with each other.

Perhaps one of the most important economic reasons for our active pursuit of trade with the U.S. is that there is such a large market there — a population ten times our own. The U.S. is one of the wealthiest nations on earth and it's on our borders. The major advantage of the large U.S. market, of course, is that if Canadian exporters are successful in selling their goods in the U.S., they can expand production and achieve economies of scale. This can enable lower prices and, therefore, make Canadian products more competitive in other world markets.

But some argue today that Canada should shift its concentration away from the U.S. — not abandon it by any means — but devote a great deal more attention elsewhere. What's the reasoning behind this?

The U.S., although still the leading nation in world trade, is losing its lead somewhat. Other countries such as Japan are gaining ground. This leads some to say that Canada should shift focus to these expanding nations.

Second, the U.S. in difficult economic times has tended to try to protect its domestic industries. There are a variety of ways in which they can do this but the result is that they discourage the purchase of goods and services from other countries. One example in this time of change is the steel industry. The U.S. steel industry has not remained competitive and has suffered some difficult times. Pressures build for the U.S. government to limit steel imports.

Those who argue that Canada should quickly develop other markets point to the risk of growing U.S. protectionism. If our eggs are concentrated in one basket we could get hurt. Hence the push to expand our markets.

> *Two way Canada/USA trade — stood at $119 billion in 1983 — greater than between any other two countries in the world. . . $119 billion is a figure that not too many wallets around this room I suspect would contemplate or can contemplate. The USA has been absorbing an increasing share of global Canadian exports. The figure for 1983 was 73%. These figures confirm vividly the importance of the USA and of a strong recovery to our trade prospects. They also highlight our vulnerability.*[20]
>
> — D. H. Burney, Assistant Deputy Minister, United States Branch to the Federal-Provincial Workshop on Trade with the USA

Are we too reliant on the U.S. as an export market? What do you think? Regardless of our decision, the U.S. will undoubtedly continue to be our major trading partner for the foreseeable future.

■ Other Trading Options

Europe, the U.S. and countries of the Pacific Rim seem to provide immense potential as export markets. But, there are many other areas of the globe to which Canada can, and does, sell exports.

What about a country like India with its enormous population? And the Middle East, South America and Africa? There is certainly potential for increased Canadian trade to these regions. But it may not be as easy as it has been for other areas that have been discussed.

In some cases, political factors enter into it. The Soviet Union and the nations of Eastern Europe (major members of **COMECON**), for instance, tend to encourage trade among themselves in preference to other countries. For this reason, Canadian wheat deals with countries such as the Soviet Union receive a great deal of attention. However, it's not as easy to sell other products which are not as essential to a nation as grain.

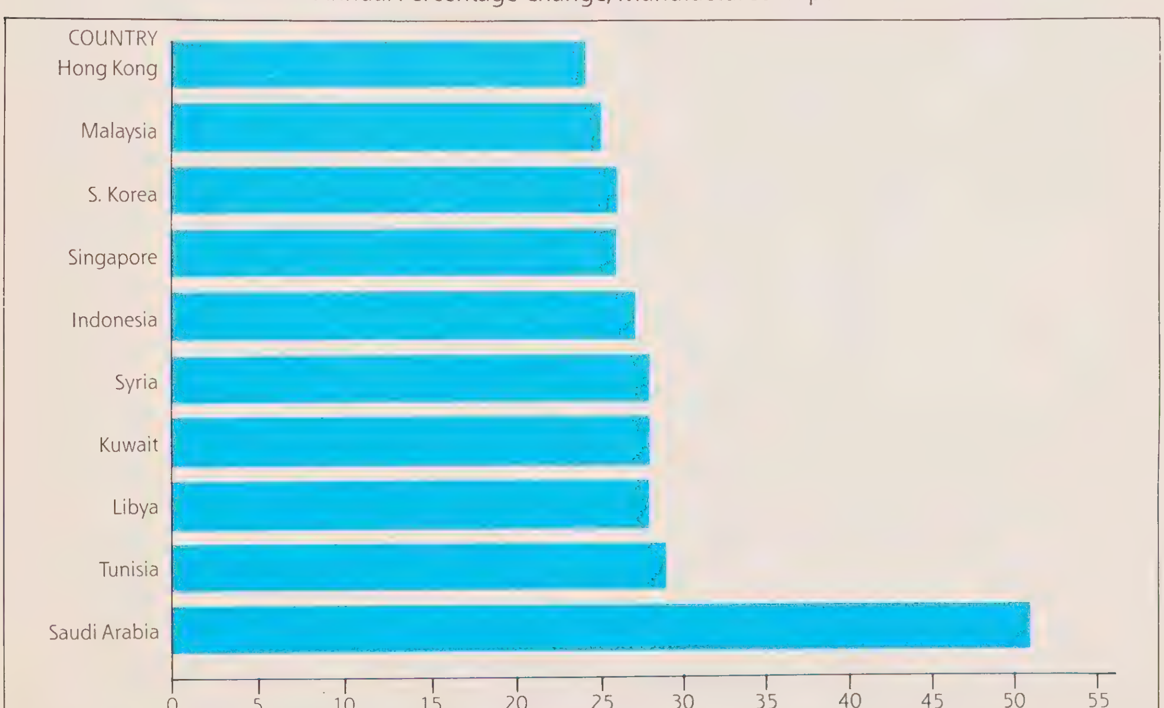
Another factor is income and the ability to purchase. The U.S. and Japan have high standards of living and people are able to afford many goods and services. In many **less-developed countries** (LDCs), the standards of living are not as high and people often don't have a very high income to spend. This is a major limit on exports to those countries. In those countries where the citizens are relatively poor, it is, however, possible to increase our export sales through their governments which are often working to try and raise the general standard of living. One little known fact is the work being done by Canadian engineers and other professionals in these developing nations of the world. The services of these professionals are some of our most competitive exports. Because services cannot be packaged and shipped, they are sometimes referred to as **invisibles**. But this is not to reduce their importance. Many of our engineering and other professional companies win major contracts themselves and often open the door for other Canadian companies through their efforts.

> *Our trade with developing countries has been growing in importance over recent years, although its share of our overall trade remains relatively modest. . . This trend is likely to continue over the coming decade as developing countries achieve higher levels of development and become more involved in the international exchange of goods and services.*[21]
>
> —Canada. Department of External Affairs

Visual 13

TEN FASTEST GROWTH MARKETS, 1970 – 1980

Annual Percentage Change, Manufactured Imports



Ontario. Ministry of Industry and Trade. Trade Policy and Analysis Branch. **Ontario Exports Mean Jobs**. Toronto: Ontario. Ministry of Industry and Trade, n.d.

Visual 13 shows the fastest growing markets in the world from 1970-80. These calculations were made by comparing increases in manufacturing imports in various countries. How many of these countries are shown on Table 8 as a major destination for our exports? What implications does this have for Canada?

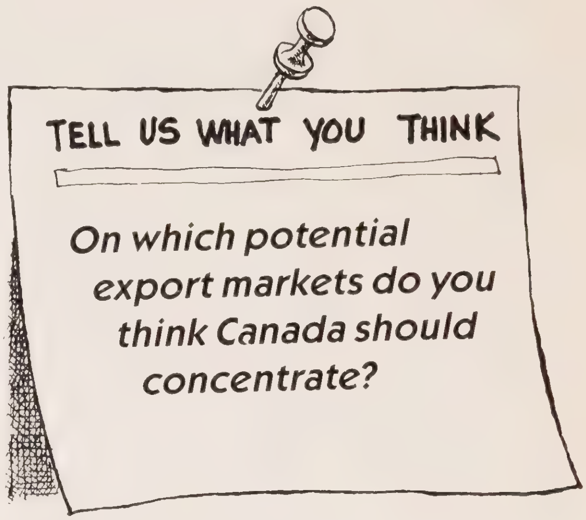
Another point can be made about the future potential of these less-developed nations. If these nations could raise their standard of living, foreign aid could be replaced by export sales. More products and expertise could be brought to world markets by these nations. Apart from humanitarian reasons, there are also economic reasons for developed countries to assist the less-developed countries.

In the eighties, however, many countries have come to be considered poor business risks. As was discussed earlier, when countries spend more than their economies generate in income, they have trouble paying for what is purchased. Often they have to borrow significantly from other countries to pay their debts. Countries in this position are often referred to as **debtor nations**. Countries such as Brazil, Mexico and others have borrowed large sums of money from foreign banks, other countries and the **International Monetary Fund** (IMF).

Many of these nations have been unable to meet their loan repayment schedules. A great deal of the income of these nations goes simply to pay interest on the debt. There are two major implications. First, when these countries have to use their money to pay interest on debt, they can't use it to buy other countries' exports. Nor can they use it for further economic development.

Second, if these nations failed to pay back their debts, the lending institutions around the world would be severely damaged. A default on a major loan could indeed hurt the entire world economy. Immense efforts are being made by the IMF and others to help these countries pay back their debts.

In summary, many other areas of the world hold out promise for export sales. There are many opportunities available today. So what are we to do? Certainly Canada should continue to put a great deal of effort into trade with the U.S. since we sell over 70% of our exports there. And it does seem that the U.S. would provide the greatest opportunity for increased export trade in the near future. The Pacific Rim holds out great promise for the longer term. But how do we proceed? Can we tap both markets effectively at the same time? Can we expand our trade with Europe? The amount of effort we assign to developing trade with various regions of the world is a key issue for Canada.



In discussions concerning Canada's efforts to expand exports, a key issue you will hear discussed is that of **free trade**. Some argue that the best way for Canada to make quick and substantial gains in export sales would be to reach a free trade agreement with the U.S. At present, Canada cannot sell some of its goods and services in the U.S. because of American tariff and non-tariff barriers. The same could be said about U.S. exports to Canada. If both Canada and the U.S. did away with their tariff and non-tariff barriers — and allowed the unimpeded flow of goods and services back and forth across the border — perhaps both countries would be better off.

Whether Canada should keep its protective barriers up against some U.S. products, or do away with them, is a major issue. We will come back to this shortly.

CHAPTER IX

THE GLOBAL FRAMEWORK FOR INTERNATIONAL TRADE

■ GATT: GENERAL AGREEMENT ON TARIFFS AND TRADE

GATT is an international agreement signed initially by 23 countries. The objective was, and is, to negotiate a reduction in the barriers to trade. Today some 90 nations have signed the GATT and participate in the negotiations.

What led countries to establish GATT? During the Depression of the 1930s, many countries imposed restrictions on trade to protect their domestic producers. After World War II, when many countries were setting out to rebuild, diplomats worked to avoid a return to the protectionist policies of the '30s.

An initial group of countries, including Canada, set out to establish GATT. The GATT treaty was negotiated in 1947 and came into effect in January 1948. GATT has two major roles: to develop a code of rules governing trade relations among nations and to be a forum for countries to discuss trade problems and address trade issues.

GATT, one might say, is like a contractual ''gentleman's agreement'' (or ''gentlewoman's''). Countries sign the GATT treaty and, by doing so, sign a contract to agree to play by the rules. If a country goes against part of the Agreement, there is no official GATT body that can swoop down and force that country to do so. Why do countries abide by the rules? There are a number of reasons.

First, the member countries signed GATT because they agreed with its objectives. Therefore, it is likely that they will work to support it and follow the rules and codes. Second, they do sign a contract to abide by the rules. This is a major commitment and not something a country would readily go against. Third, is the power of leverage which other countries can use against another country which breaks the rules (an example would be **dumping**).

Visual 14

COUNTRIES PARTICIPATING IN THE ''TOKYO ROUND'' OF TRADE NEGOTIATIONS

Algeria
Argentina
Australia
Austria
Bangladesh
Benin
Bolivia
Botswana
Brazil
Bulgaria
Burma
Burundi
Cameroon
Canada
Chile
Colombia
Congo
Costa Rica
Cuba
Czechoslovakia
Dominican Republic
Ecuador
Egypt
El Salvador
Ethiopa
European Communities and member states
- Belgium
- Denmark
- France
- Germany, Fed. Rep. of
- Ireland
- Italy
- Luxembourg
- Netherlands
- United Kingdom of Great Britain and Northern Ireland

Finland
Gabon
Ghana
Greece
Guatemala
Haiti
Honduras
Hungary
Iceland
India
Indonesia
Iran
Iraq
Israel
Ivory Coast
Jamaica
Japan
Kenya
Korea, Rep. of
Madagascar
Malawi
Malaysia
Mali
Malta
Mauritius
Mexico
New Zealand
Nicaragua
Nigeria
Norway
Pakistan
Panama
Papua New Guinea
Paraguay

Peru
Philippines
Poland
Portugal
Romania
Senegal
Singapore
Somalia
South Africa
Spain
Sri Lanka
Sudan
Swaziland
Sweden
Switzerland
Tanzania
Thailand
Togo
Tonga
Trinidad and Tobago
Tunisia
Turkey
Uganda
United Kingdom (on behalf of dependent territories)
United States of America
Uruguay
Venezuela
Vietnam
Yemen, Democratic
Yugoslavia
Zaire
Zambia

Canadian Manufacturers' Association. **Multilateral Trade Negotiations 1973-1979, Summary of Tariff Agreements.** Toronto: CMA, 1979.

Table 10

TARIFF AVERAGES[1] ON INDUSTRIAL IMPORTS (EXCLUDING PETROLEUM) BEFORE AND AFTER IMPLEMENTATION OF THE TOKYO ROUND AGREEMENTS, EUROPEAN ECONOMIC COMMUNITY AND NINE OTHER DEVELOPED COUNTRIES

	Tariff averages		
	Before the Tokyo Round	After the Tokyo Round	Reduction rate
	(Per cent)		
European Economic Community	6.6	4.8	27
Sweden	5.2	4.3	23
Norway	4.2	3.2	23
Switzerland	3.2	2.5	23
Austria	9.0	7.8	13
Finland	6.0	4.8	20
United States	6.2	4.4	30
Canada	12.7	7.9	38
Japan	5.2	2.6	49
New Zealand	22.4	17.6	21

[1]The comparability of tariff levels and of their practical incidence is affected by differences in the methods of valuation for customs purposes. The averages set out above include duty-free items. Note that averages disguise variations in tariffs, which are wider in some countries than in others. Here, the simple average on each tariff line is weighted by each market's MFN imports (those subject to "most favoured nation" treatment).

Source: Trade Policy Research Centre (London), *The World Economy* 2, no. 3 (September 1979), p. 328.

Economic Council of Canada. **On the Mend: Twentieth Annual Review.** Ottawa: Supply and Services Canada, 1983.

According to Table 10, which country has reduced its level of import tariffs the most since the Tokyo Round of GATT? Which has reduced them the least? Which country shown has the lowest level of import tariffs (after the Tokyo Round)? Which has the highest? Which has the second highest?

For example, suppose one country (A) went against the rules of GATT in its trade relations with a fellow member country (B) of GATT. Other member countries of GATT could rally behind country B and impose trade penalties on country A to force it to abide by the rules. This power of leverage discourages countries from breaking the rules and codes of GATT. The potential cost in terms of export sales to other GATT countries is usually just too high.

GATT has three major objectives:

- to reduce tariff barriers among many nations through **multilateral** negotiations

Visual 15

GATT ROUNDS OF MULTILATERAL TRADE NEGOTIATIONS

Order	Date	Location
1st	1947	Geneva (Switzerland)
2nd	1949	Annecy (France)
3rd	1951	Torquay (England)
4th	1956	Geneva
5th	1960-62	Geneva
6th	1964-67	Geneva[a]
7th	1973-79	Geneva[b]

[a]Kennedy Round.
[b]Tokyo Round.

Canadian Farm Economics, vol. 13, no. 4, August 1978

- to ensure that tariffs and other policies are applied equally to all member nations, i.e. ensuring that when one country grants a trade concession to another, the same concession must be available to all other trade partners. This is referred to as the **most-favoured nation** (MFN) principle
- to work toward the gradual reduction and elimination of non-tariff barriers.

All the nations of GATT participate in a series of on-going negotiations. Major negotiations have been referred to as Rounds. A GATT Round is far from a two-week trip with some discussions around a table. Negotiations on certain key issues will go on over a number of years. This reflects the detail, difficulty and effort in reaching agreements.

Although a number of notable countries have not participated in GATT, nevertheless, GATT includes the countries which conduct the vast majority of world trade. The member countries of GATT now account for more than four-fifths of the world's trade.

Why is Canada such an active and enthusiastic supporter of GATT? There are a number of reasons.

- Alone, Canada with its relatively small market doesn't have much leverage with other countries. If another country took some action that hurt our trade, our retaliation might not hurt that nation a great deal. However, if an act against Canada violated the GATT treaty, Canada could have the support of the other GATT members. This increases Canada's leverage substantially.
- The most-favoured nation principle has been successful in preventing countries from taking discriminatory action against Canada. It has also brought benefits since when one member of GATT grants a trade concession to another, it must be available to all members.
- GATT provides an agreed upon set of international rules which promote stability and order in the conduct of trade relations.

> *Canada must participate in . . . GATT negotiations for two reasons: first, reciprocal tariff reductions will provide major economic benefits for all participants; and second, opting out would leave Canadian industry in a well-nigh hopeless position to compete with other countries that would — if these negotiations succeed — enjoy freer access to world markets. No sensible case can be made for Canada opting out and facing the increased discrimination against its products on world markets that this would imply . . .*[22]
>
> — Economic Council of Canada

With all of its usefulness for Canada, GATT does have some weaknesses. The negotiations have not been very successful dealing with non-tariff barriers. There have been problems controlling and managing preferential trade arrangements. And GATT has not worked out an effective trade relationship between developed and developing nations.

There are some who argue that GATT has outlived its usefulness. They say that most issues now arise between two countries, that this is an era of **bilateral**, rather than multilateral, negotiations.

> *Governments are not always able to cope with . . .* [trade] *problems within the existing framework of GATT. (The issue) is to know whether there is some way in which the dispute settlement system within GATT could be improved to facilitate solutions and equally whether governments feel that they could adhere more closely to the existing system, whether it would be in their interest to do so.*[23]
>
> — Donald McPhail, Canadian Ambassador at a GATT ministerial meeting

But GATT will continue to serve its purpose if future negotiations include:

- the increased trade in services (invisibles) among nations
- non-tariff barriers
- investment policies of member nations (e.g. FIRA in Canada)
- agricultural trade
- fisheries trade
- the evolution, spread and implications of high technology
- trade relations between developed and developing nations (This issue is often referred to more broadly as the **North-South dialogue**, i.e. discussions between the more developed nations of the northern hemisphere with the less-developed nations of the southern hemisphere)

The most important of these will be the discussions of non-tariff barriers (NTBs). If NTBs are allowed to develop and spread, they can undo much of the work that has been accomplished in past negotiations to lower tariffs and increase trade.

In summary, GATT has played, and will continue to play, a key role in the conduct of world trade.

Protection Vs. Protectionism

One distinction should be made when discussing the issue of protection. There is a difference between the terms protection and **protectionism**.

Protection refers to the tariffs placed on certain goods and services coming into the country. Canada has protective tariffs. We have had more and higher tariffs in the past. Protection of certain industries is allowed under the GATT negotiations. The major objective of GATT is to lower the levels of protection, and GATT is succeeding. But the countries participating in GATT recognize that all countries can't simply and quickly eliminate all of their tariffs.

Protectionism, on the other hand, refers more to a spirit of policy. For example, Canada has protection for certain industries, which is GATT approved. In a spirit of protectionism, Canada could go against GATT and attempt to increase the level of protection by more and/or higher tariffs or non-tariff barriers.

Protectionism, then, refers more to a philosophy of trade policy. GATT encourages countries to switch from a policy of protectionism to one of fewer barriers and freer trade.

CHAPTER X

THE DEBATE OVER FREE TRADE WITH THE U.S.

When many countries meet to discuss trade issues, the discussions are referred to as being multilateral. When only two countries are involved in discussions, such talks are said to be bilateral. Canada, in addition to the GATT negotiations, participates in trade talks with other countries directly. For example, Canada is engaged in many discussions with the United States to negotiate trade policies.

The key point to recognize is that trade policy cannot be decided by Canada alone. Trade is a two way street. The conditions of trade, rules of trade and environment for trade have to be negotiated with other nations. Meetings must occur. Discussions must take place. Two countries can be better off through trade only if they are both effective in negotiations.

Canada has been on a path of less protection. However, some Canadian industries are still protected by tariffs and by non-tariff barriers. Canada will face some key decisions in the future with regard to protection.

One issue is a particularly predominant one in Canada at the moment. You will have probably heard reference to the issue of free trade with the United States. Perhaps a better phrase would be the issue of whether or not to allow the unimpeded flow of goods and services back and forth across our borders. At present, approximately 75% of the trade between the U.S. and Canada takes place without tariffs being applied. The issue is whether or not to do away with all tariff protection and let all goods flow freely.

As discussed in Chapter VII, ever since Sir John A. Macdonald's National Policy, Canada has placed tariffs on certain imports to protect Canadian producers. The argument in support of this was that Canadian companies, with a smaller market than countries like the U.S., needed protection to develop, expand, become more competitive and help create jobs for Canadians.

From the outset this strategy was controversial. Many of the tariffs were on manufactured goods and the manufacturing industries tended to be concentrated in Ontario and Quebec. Other regions of Canada complained for two main reasons: people throughout Canada had to pay higher prices for manufactured goods because of the protection and other countries reacted by developing policies that hurt certain Canadian exports — particularly resources which were exported from Western and Eastern Canada.

Some in Central Canada have countered this argument. They say that protection helped industries develop, created jobs and generated income. The income generated has been used for further development and the purchase of goods from Eastern and Western Canada.

The debate continues. But for the last 50 years or so, Canada has been reducing the amount of protection. This is particularly true since the beginning of the GATT negotiations. Today, serious discussions are occurring with respect to significantly freer trade.

As discussed in Chapter VIII, many Canadians see our greatest potential in a free trade relationship with the United States. Others consider such an arrangement a terrible threat. There are arguments made on both sides.

The Arguments in Favour of Free Trade with the United States

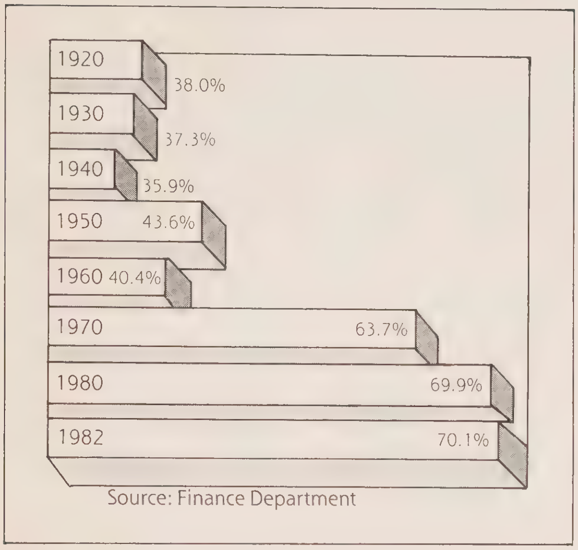
> *In a free trade area there is no need for either country to sacrifice sovereignty. And the advantages to Canada are clear: Canadian producers in virtually all sectors import large amounts of their components from their largest trading partner, the United States. Freed of tariffs and non-tariff barriers, the cost of those imports would be reduced dramatically, and the price of finished products would decline correspondingly. For the first time in history Canadian producers would be able to achieve economies of scale.*[24]
>
> — Kevin Doyle, Editor, Maclean's

- If Canada negotiated the free flow of goods and services with the U.S., the U.S. protectionist policies which exist now would have to be dropped. This would open the door for Canadian exporters to sell more goods in the U.S.

  For example, most states have a "Buy America First" policy. Under this policy, state governments will buy goods and services from American producers, even if they cost more than those produced by companies in other countries. If Canada negotiated a free trade deal with the U.S., these state policies would not be possible, enabling Canadian producers to compete for those sales.
- Expanded trade sales by Canadian exporting companies could help these companies achieve economies of scale and become more efficient.
- As Canadian companies became successful under conditions of free trade, they would become more attractive to investors and more funds would become available to help Canadian producers improve efficiency.
- Less protection and regulation in Canada may in itself attract more foreign investment. Foreign investment can help to expand and improve production and to create jobs.
- The greater opportunity to compete in the U.S. would provide strong motivation to Canadian producers to undertake more research and development in an effort to become more efficient.
- In a free trade environment, it is very likely that some Canadian firms and industries would do well while others would fail. Some argue that this would work out to be good for Canada in the long run because:
  - Canada would end up specializing more and becoming more efficient at what it does produce
  - investment would shift from those areas in which we can't compete internationally to those in which we can
  - the marketplace would determine the winners and losers on the basis of those which are efficient and competitive.

Visual 16

TARIFF-FREE TRADE WITH THE U.S.



"Debate heats up over freer trade with U.S." by Richard Gwyn. **The Toronto Star**, May 6, 1984.

Visual 16 shows the percentage of our trade, in various years, which has taken place with the U.S. without tariffs. Why do you think there was a decline in tariff-free trade from 1930 to 1950? Why do you think there has been such a sharp increase in tariff-free trade through the '60s to today?

- Another argument in favour of free trade is that it would lower prices for Canadians. Tariffs increase prices, so the elimination of tariffs would lower prices. And to the extent that free trade would increase the efficiency of Canadian producers, this would lower prices.
- If free trade enabled certain Canadian companies to expand export sales, employment for Canadians in these industries would increase.
- Finally, those in support of free trade argue that it is the direction we are headed anyway. The GATT negotiations are moving us further and further towards free trade with the U.S., as shown in Visual 16.

The Arguments Against Free Trade with the U.S.

> *Which Canadians would undoubtedly benefit from freer trade? Some consumers who would be able to import cheaper U.S. goods, and some export-oriented industries that could make a go of it in the U.S. market. But some Canadians — no one knows how many — would lose jobs in the process, and our political and economic independence would be compromised.*[25]
>
> — The Toronto Star

- A likely consequence of free trade would be that certain Canadian producers would suffer a loss of sales to competing imports. Indeed, certain companies, and perhaps some industries, might fail. This can have two consequences for Canada:

  — those businesses or industries would be lost and would cease to offer their products for sale in Canada

  — jobs (perhaps the related skills) in those companies or industries would be lost.

  This would be a particularly difficult problem for those Canadians who live in towns where much of the employment comes from a protected company. For example, in some small towns, a textile plant may be providing jobs to many of the town's people. If the textile firm in the small town failed, where would the people find employment? New firms would have to be established in those towns, the people would have to move or they would become unemployed.

  This would be a particular problem in the short run. The short run isn't a specific period of time — it is a term used in contrast to the long run. In the long run, major changes can occur — new factories can be built, current companies can be expanded, new technology can be implemented, people can be trained for new occupations and so on. The short run refers to a period of time too brief for these changes to occur.

  Free trade will pose particular problems for the short run. A business can close down in a day. People can be put out of work and incomes can be lost. It will be the long run before new businesses are established and people can be retrained. Some may easily transfer to other jobs but many may face the problems of unemployment in the short run.

- An argument also made against free trade is that it will threaten Canadian sovereignty. The thought is that a free trading relationship with the U.S. will lead to a closer merger of U.S. and Canadian society. They fear pressures to establish more linkages between us. Some argue that we may have to conform more closely to U.S. tax policies, monetary policies and so on. Canadian products and methods may become less distinguishable from the U.S. The U.S., being so large, may dominate Canada.

  An interesting point to note here is the level of intracorporate trade into and out of Canada. This is shown in Table 11. Intracorporate trade refers to trade between subsidiaries of the same companies. For example, if parts were shipped in from the head office of a foreign company to its Canadian subsidiary for assembly, this would show up as an import into Canada. If the Canadian subsidiary produced parts and shipped them to the head office in another country for assembly that would show up as a Canadian export.

  Reference is sometimes made to these intracorporate trade figures by those who are concerned about the sovereignty of Canada and the ability of Canada to fare well in a free trade environment.

Table 11

CANADA-U.S. INTRACORPORATE TRADE, SELECTED YEARS, 1965-79[1]
Proportions of all import and export trade with the United States that is between foreign-owned Canadian subsidiaries and their parent companies

	1965		1970		1975		1979	
	Imports	Exports	Imports	Exports	Imports	Exports	Imports	Exports
	(Per cent)							
Mining and primary metals	77.9	82.4	81.3	84.1	71.3	72.8	81.2	70.3
Gas and oil	80.8	62.5	72.9	68.2	87.7	51.6	87.3	53.8
Machinery and metal fabricating	79.3	95.2	79.3	96.1	78.1	70.3	80.3	76.8
Transportation equipment	67.0	59.0	76.0	91.7	76.1	94.4	81.5	93.5
Electrical products	69.7	80.0	64.2	54.5	64.7	75.4	65.0	70.3
Chemical products	55.0	34.4	60.4	64.9	67.2	50.8	68.8	80.6
Food and beverage	46.3	62.5	42.2	66.1	37.1	59.6	27.7	30.8
Pulp and paper	21.9	51.4	28.6	54.5	28.1	59.0	58.0	52.1
Other manufacturing	64.9	67.9	69.8	65.2	72.3	72.5	83.9	81.8
Wholesale trade	80.6	94.8	78.5	90.6	83.1	92.1	76.5	90.6
Other nonmanufacturing	35.0	100.0	60.0	70.0	75.2	100.0	68.9	46.2
Total	66.9	63.0	73.3	81.6	74.5	80.1	78.9	81.3

[1]Based on a sample of larger foreign-owned firms accounting for approximately half of the sales volume of all foreign-owned firms in Canada.

Source: Department of Industry. Trade and Commerce, *Foreign Owned Subsidiaries in Canada*. Ottawa, various issues.

Economic Council of Canada. **On the Mend: Twentieth Annual Review.** Ottawa: Supply and Services Canada, 1983.

From Table 11, in which sector in 1979 was there the largest level of intracorporate imports? In which sector in 1979 was there the largest level of exports?

The sovereignty issue is a difficult one to detail. Some argue that it isn't an issue — that the free flow of goods and services will not jeopardize Canadian sovereignty. This is definitely an area in which each Canadian has to make a personal decision.

- One argument made against free trade, or at least for caution, is that once such a decision is made, it will be irreversible. Once negotiated, it would be very difficult for Canada to go against the agreement and reinstate protectionism. Furthermore, the Canadian companies that fail will be gone before any new negotiations could likely take place.

  This argument stresses the magnitude of this decision and its consequences. It is important to be sure we want free trade because, once we have it, there will likely be no going back.

- If Canada did negotiate free trade with the U.S., what would happen if the U.S. ever reverted to protectionist policies? This would be a major blow to Canada. Those who argue against free trade argue that there may be no way for Canada to guarantee the U.S. commitment to the arrangement.

- If free trade exists between Canada and the U.S., the branch plants that were established here to jump the tariff wall may close down. In fact, some companies have left as tariffs have been eliminated in some areas. Many factors will affect whether a branch operation will close down. Any that did close would mean a loss of foreign investment and the jobs provided by these branch plants.

- Those against free trade say that making Canada specialize in our areas of strength is not necessarily such a good thing. By producing a smaller variety of goods, Canada loses diversity of skills and increases our dependence on other countries for the lost goods.

- Under free trade with the U.S., would new investors put their money in Canada or the U.S.? The answer to this question will be a major factor in determining whether free trade is good for Canada. If, after free trade is established, Canadian firms can attract new investment, then free trade may be very good for Canada.

  But if investors see non-Canadian companies as more competitive and invest in them, then free trade could hurt Canada.

  A key question for Canadians to consider when thinking about the free trade issue, then, is where will investment go after free trade. If we feel confident in Canada and Canadian firms, in their ability to compete, then free trade should not be a threat. If, on the other hand, we have doubts about Canada's ability to attract investment, then we should proceed with great caution.

■ THE SECTORAL FREE TRADE OPTION

There is an option one step back from a full free trade relationship with the United States. This option is referred to as sectoral free trade. It works this way.

Canada and the U.S. negotiate specific areas of free trade. For example, free trade could be allowed in mass transit vehicles, furniture, farm implements and clothing. The point of sectoral free trade is that the two countries would come to a mutual agreement on certain areas of free trade while maintaining the right to protect some industries. Perhaps, through a series of negotiations, full free trade would eventually result.

There are pros and cons to this approach. Those who argue in favour of it say that it is a more gradual approach and hence less risky. It would allow Canada to pursue a series of negotiations to achieve the best possible deal and help to avoid the irreversible consequences of full free trade. It can also be argued that the sectoral approach, being more gradual, would allow more time for Canadian companies to become competitive.

Arguments against the sectoral approach include the following. The U.S. and Canada would have a hard time agreeing on which sectors should be open to free trade. Both countries will seek free trade in their best areas, that is, where they stand to do well. The implication of this is that the U.S. would be faced with letting in one of Canada's most competitive products (for example, mass transit vehicles) and Canada would have to let in one of the U.S.'s most competitive products (for example, computers). Both countries would have to risk certain industries to allow others to succeed.

The argument can then be made that if this is going to happen anyway, there is little to be achieved by slowly negotiating sectoral free trade rather than broadly negotiating full free trade. Visual 16 shows that the proportion of tariff-restricted trade between the two countries has been decreasing quite rapidly.

Another argument made against the sectoral free trade approach comes from those who believe Canada should concentrate on its strongest, most competitive industries and allow the non-competitive to go out of business. They feel that the sectoral approach would prevent the resources invested in non-competitive companies from being shifted into stronger firms and industries.

Canada's free trade and protectionist policies are under constant review. Canadians should be informed about various policy options and communicate their opinions to their federal and provincial governments. The future direction and success of the Canadian economy will depend on the effective decision-making of all Canadians.

■ THE CANADA-UNITED STATES AUTOMOTIVE PRODUCTS AGREEMENT (THE AUTO PACT)

In any discussion of free trade between Canada and the U.S., you will undoubtedly hear mention of the Auto Pact. The Auto Pact is an agreement between Canada and the U.S. with respect to trade in automotive products.

Before 1965, U.S. companies like Ford, General Motors, Chrysler and American Motors faced a 15% tariff at the Canadian border. To avoid the tariff, these companies established branch plants in Canada, which were essentially mini-replicas of the large U.S. plants. The branch plants produced all models of cars for the Canadian market.

As you can imagine, these branch plants had short production runs and were quite inefficient. Canadian auto-workers' wages were lower than those in the U.S. Canada had relatively low auto exports. And the opportunities for growth were quite limited.

The Auto Pact was an agreement signed between Canada and the U.S. which changed the complexion of Canada's auto industry considerably.

Signed on January 16, 1965, the Auto Pact allowed for the free trade of automotive products, vehicles and parts, across the border. An individual could not buy a car in the U.S. and bring it into Canada duty free. (Although a citizen of the U.S. can buy a car and take it back to the U.S. duty free.) But manufacturers could ship car parts and completed vehicles across the border without duty.

What impact did this have? There was a major impact on efficiency. Canadian operations no longer had to be mini-replicas producing all models. Instead, Canadian operations began specializing in the production of certain models entirely. This meant longer production runs and economies of scale. The Auto Pact led to a small-scale form of world product mandating.

The Auto Pact had the effect of bringing Canadian auto-workers' wages more in line with those in the U.S. Efficiency increases meant prices moved closer to those charged in the U.S. And Canada's exports of auto products increased. Today they represent our largest manufactured export.

The Auto Pact obviously had a considerable impact on Canada. Some years ago, a study was done which showed the Auto Pact increased Canada's GNP by as much as 4.7%.

Twenty years after it was signed, there is now a call for renegotiation of the Auto Pact. Regardless of what happens in the future, the Auto Pact is an interesting example of negotiated free trade for us to study.

CHAPTER XI

FUTURE TRADE ISSUES AND QUESTIONS

Throughout this publication, issues and questions have been raised on the subject of trade.

We hope that this publication has been able to provide you with some focus and insight in considering these matters. It would seem appropriate to conclude our text with a review of some key trade issues facing Canada.

Where does Canada stand today in the global trading context? For one thing, we are not a member of a major trading bloc. We are one of the few industrialized countries in the world without relatively uniform tariff-free access to a market of a least 100 million people.

We are still largely reliant on our resource industries for trade and employment. We are beginning to give increased attention to alternatives — high tech, manufacturing, etc. The vast majority of our trade is with the United States. We are expanding our efforts to increase our trade with other parts of the world.

We still protect certain industries and face decisions with respect to whether to continue to do so.

Non-tariff barriers tend to be developing rapidly throughout the world (and indeed within Canada). Their proliferation threatens the gains achieved from past negotiations to lower tariffs and enable freer trade. How is this problem to be addressed?

Our share of world trade has declined in recent years. We hold ambitions to change that. How do we do it?

We continue in Canada to produce a wide range of products. Perhaps we would be better off to embark on a path of increased specialization, rationalization and realization of economies of scale.

The level of foreign investment in Canada is an issue we have to address. Do we actively encourage it? Is it threatening to us? How could we do without it? And so on.

Our trade in services is usually in deficit. How do we correct this imbalance?

We still have some restrictions on trade with the U.S. but we are committed to increasingly free trade under the GATT. Do we want to pursue sectoral free trade with the U.S.? Do we want to establish a free trade treaty? If so, what kind — customs union? free trade area? common market?

Our productivity performance in Canada has been declining over recent years relative to other countries. How can we reverse that trend?

How do we improve our labour-management relations?

Spending on research and development in Canada is relatively lower than in other countries. How do we increase our R & D and improve our innovation record? How do we improve our performance as international entrepreneurs?

We have some Canadian manufacturing success stories — Northern Telecom, Bombardier, Spar Aerospace, and others. How do we keep strong companies strong and bring along others to be as successful?

Many of Canada's resource companies are world leaders — highly successful and highly productive. How do we ensure that they maintain their international stature?

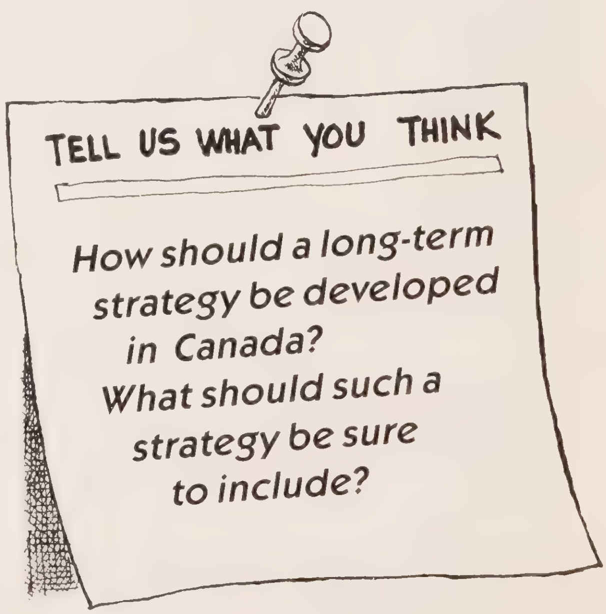
We tend to be slower than many other industrialized countries at implementing new technology. How do we shorten the time lag?

Throughout the world countries are struggling with the problems brought about by economic change. As production methods change, as product demand changes, as technology changes, business and industries must change. New skills are required. How do we adjust effectively in Canada? How do we enable our businesses and industries to adopt the most modern methods without displacing workers and creating high unemployment? Can we find innovative ways to do this — become world leaders?

Can we improve our management skills — not simply adapt those of other countries. Japan has sparked great interest in new management techniques. But Canada is unique in many ways. We can't just copy what others have done. We have to be innovative and develop successful techniques that work for our country, in our businesses and with our labour. Can we do this?

All of these challenges lead us to the need to make decisions. Canadians as a nation will have to establish objectives, implement strategies, create policies and develop innovative methods to achieve our goals. Perhaps the foremost task confronting us is to determine how we develop our strategy and who will develop it.

Can we, as a nation, establish clear, long-term trade objectives? Can we develop a national commitment to fulfilling these objectives and set out to achieve success?



These are significant issues and questions. If answers still elude you, we hope you are at least confident in your ability to seek them out. Your opinions will matter. Your efforts and decisions will affect Canada's success.

NOTES

1 Camille A. Dagenais, Chairman, The SNC Group. Extract from an address to the International Business Council of Canada, April 18, 1984.

2 ''Dollar gain to 75.78 cents''. **The Globe and Mail, Toronto**, July 25, 1984.

3 ''Record trade surplus promises more jobs'' by Ann Auman. **The Toronto Star**, August 10, 1984.

4 ''Foreign trade surplus hits record $2.1 billion'' by Peter Cook. **The Globe and Mail, Toronto**, August 10, 1984.

5 Roy Phillips, President, The Canadian Manufacturers' Association.

6 Roy Phillips, President, The Canadian Manufacturers' Association.

7 Camille A. Dagenais, Chairman, The SNC Group. Extract from an address to the International Business Council of Canada, April 18, 1984.

8 ''Trying to control protectionism's tide'' by John Hay and Iain Guest. **Maclean's**, December 6, 1982.

9 The Honourable Michael Wilson, M.P. Extract from an article by Richard Gwyn, ''We must learn to hustle in the new world economy''. **The Toronto Star**, May 9, 1984.

10 ''Specialization seen as key to our future'' by Ronald Anderson. **The Globe and Mail, Toronto**, August 17, 1982.

11 The Right Honourable Pierre E. Trudeau. Extract from an address at the annual convention of the American Newspaper Publishers' Association, April 1984.

12 A senior business executive. Extract from an article by Martin Goldfarb, ''Work ethic fading, but it remains key to success, Canadians say''. **The Toronto Star**, May 22, 1984.

13 Robert White, Canadian Director, United Auto Workers. Extract from an article by Richard Gwyn, ''We must learn to hustle in the new world economy''. **The Toronto Star**, May 9, 1984.

14 David Culver, Chairman, Alcan Aluminum Ltd. Extract from an article by Richard Gwyn, ''We must learn to hustle in the new world economy''. **The Toronto Star**, May 9, 1984.

15 ''Risks of protectionism not to be taken lightly'' by Ronald Anderson. **The Globe and Mail, Toronto**, May 9, 1984.

16 The Honourable Donald Johnston, M.P. Extract from an article by James Fleming, ''The recovery takes shape''. **Maclean's**, July 18, 1983.

17 Camille A. Dagenais, Chairman, The SNC Group. Extract from an address to the International Business Council of Canada, April 18, 1984.

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20 D. H. Burney, Assistant Deputy Minister, United States Branch to the Federal-Provincial Workshop on Trade with the U.S.A. Extract from an address, Montreal, February 27, 1984.

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GLOSSARY

The following definitions have been extracted from **A DICTIONARY OF CANADIAN ECONOMICS** by David Crane (Edmonton: Hurtig, 1980). We refer the interested reader to this reference work for more complete and additional definitions.

absolute advantage The ability of a country or firm to set the price of a particular good or service without fear of competition, because it possesses a unique resource or technology.

balance of payments A summary of all the transactions between Canadians and residents of the rest of the world over a given period of time. The balance of payments is divided into two accounts: current and capital. The current account records the flow of goods and services between Canada and the rest of the world. The capital account consists of long- and short-term capital flows between Canada and other countries. These flows include direct and portfolio investments.

balance of trade The difference between the dollar or money value of a country's exports and imports of merchandise or of goods and services.

barter A transaction in which goods or services are exchanged for other goods or services rather than money. Barter is also used in trade between nations, with a country rich in resources but poor in manufacturing, for example, exchanging a fixed amount of a commodity for major machinery and equipment (countertrade). 10% to 20% of world trade takes this form.

bilateral agreement An agreement on trade, investment, or other economic relations negotiated between just two countries. A recent example of a bilateral agreement is the 1965 Canada-United States Automotive Products Agreement.

Canada-United States Automotive Products Agreement An agreement signed by Canada and the United States on 16 January 1965, to create a North American market for motor-vehicle production and, in the process, give Canadian workers more jobs and Canadian consumers lower prices for North American automobiles.

Canada-United States Defence Production Sharing Arrangement An agreement between Canada and the United States to maintain a long-term rough balance in defence trade between the two countries. It's purpose is to facilitate the development of a defence industry in Canada by permitting the duty-free entry of most military products.

Canada-United States trade agreements Trade agreements signed between the two countries in 1935 and 1938 to reverse protectionist trends in both countries.

Canadian International Development Agency (CIDA) A federal agency responsible for the administration of Canada's foreign-aid or official development-assistance program. Canada's aid programs are divided into three principal groupings: multilateral aid, bilateral aid, and food aid.

capital 1. In economics, one of the factors of production that is essential to the functioning of the economy. It represents the mines, factories, machinery, railways, power stations, department stores, inventories, and all the other capital goods that are used to produce goods and services and on which income is earned. The capital in an economy increases as new investments are made from the profits earned on existing capital. 2. In financial markets, the funds available for investment in financial assets, such as shares, bonds, or real property. 3. In business, the total funds invested in the company to enable it to carry out its activities.

capital account See balance of payments.

capital-intensive industry An industry that makes heavy use of capital equipment, such as machinery, relative to its labour force and level of output. Examples of capital-intensive industries include oil refining and petrochemicals.

capital investment The amount of spending in the economy each year to replace worn-out and obsolete production facilities and to increase the productive capacity of the economy.

capital movements Flows of long-term and short-term capital between Canada and other countries. The main factors affecting the flow of money back and forth across the border are differences in interest rates and exchange rates. Funds invested by corporations and individuals, especially short-term funds, tend to seek out the highest interest rates.

COMECON (Council for Mutual Economic Assistance) A council created in 1949 by the Soviet Union, originally established as a means of integrating the economies of Eastern Europe and Outer Mongolia with that of the Soviet Union. Its members include, in addition to the Soviet Union, Czechoslovakia, East Germany, Poland, Hungary, Romania, Bulgaria, Outer Mongolia, Cuba, and Vietnam.

commercial policy Government policy that deals with foreign trade and investment, and which includes tariff and other trade agreements, export-financing facilities, rules to prevent dumping and other unfair trading practices, the establishment of trade-promotion offices in other countries, and export incentives.

common market An arrangement among sovereign nations to eliminate tariffs and other barriers among them and to permit the free movement of goods, services, people, and capital. A common market also implies a common external tariff on trade by all members of the common market with non-members.

comparative advantage An important principle in international trade, based on the assumption that each country is probably more efficient than others in producing some particular good or service and that each country should concentrate on producing what it can produce more efficiently. Even if two countries can produce the same goods with equal efficiency, it still pays for each to specialize in just some of those goods and import the others, since specialization will lead to greater total production and lower costs for both. A country is said to have a comparative advantage in the goods that it can produce most efficiently.

countertrade See barter.

current account See balance of payments.

customs union A free-trade agreement among two or more nations who also impose a common external tariff on imports from nations outside the customs union.

debtor nation A nation that runs a recurring balance-of-payments deficit. It must attract foreign capital — either debt capital or equity capital — to meet its international obligations, since it cannot pay its way in the world through the export of goods and services or from its income from foreign investments and other sources.

devaluation The reduction by a government of the par or official value of its currency in terms of the value of the currencies of other nations. Devaluation can serve as an economic stimulus, since it reduces the price of exports and makes them easier to sell, while raising the price of imports, making it easier for domestic producers to compete against imports. It also has an inflationary impact, since it raises the price of essential imports.

developed country A country that has a per capita income of at least two thousand dollars, and fairly high standards of health care, education, housing, advanced industrial development, technology, and agricultural productivity. Canada is an example of a developed country.

developing countries See less-developed countries.

direct investment Investment made for the purpose of exercising direct control over an operating company. Foreign direct investment consists of direct investments made by corporations or individuals from one country in the business sector of another country.

diseconomies of scale An increase in the average cost per unit of production, as production rises, because of the exceedingly large scale on which the producer operates. This can be due to external factors, for example, higher wages resulting from increasing demands for labour by competing firms in the same industry.

dumping The sale of a product in a foreign market at a price less than that charged in the country of origin. It is barred under the General Agreement on Tariffs and Trade (GATT).

economies of scale Reductions in the average cost of production, achieved by increasing the volume of output and thus using the various factors of production more efficiently. But these economies can only be achieved when the volume of production is high enough.

embargo A government-imposed ban on the import or export of certain goods for health, national-security, political, or other reasons.

entrepreneur A person who either starts his/her own business or aggressively expands an existing one. An entrepreneur is normally identified with risk-taking and new ideas. The entrepreneur is considered vital in a dynamic economy, since he/she is often in the forefront of innovation, new technology, and new products and services.

exchange rate The price of a national currency — the Canadian dollar, for example — in terms of another. It is a way of stating the number of Canadian dollars it will take to buy a unit of a foreign currency, or the number of units of a foreign currency it will take to buy a Canadian dollar.

Export and Import Permits Act The act giving the federal government the power to control the volume and destination of exports and to regulate imports.

exports Goods and services produced in one country that are sold and shipped to another. Merchandise exports — sometimes called visibles — consist of products or commodities. Service exports — sometimes called invisibles — consist of banking and insurance services, transportation, travel and tourism, technology and know-how, and the receipts from foreign investment, such as interest and dividends.

European Economic Community (EEC) A common market agreed to by six Western European countries (France, West Germany, Italy, the Netherlands, Belgium, and Luxembourg) in March 1957 under the Treaty of Rome, and which came into being on 1 January 1958. Since then, the EEC has been expanded to include Britain, Ireland, Denmark, and Greece. Negotiations are proceeding to include Spain and Portugal.

European Free Trade Association (EFTA) A free-trade area established by seven European nations in 1959 as an alternative to the European Economic Community. Its members were Britain, Sweden, Norway, Denmark, Switzerland, Portugal, and Austria. EFTA was shattered in 1973, when Britain and Denmark became members of the European Economic Community. The EEC has negotiated free-trade agreements with EFTA members who decided not to seek membership in the community. Thus, the sixteen nations of the EEC and EFTA are joined together in a free-trade arrangement.

foreign aid Assistance by developed countries to help the less-developed countries to carry out programs of economic development and thus raise their standard of living; foreign aid may also be provided as emergency relief in the case of famine, flooding, earthquakes, or other natural disasters.

foreign exchange The currencies of other countries used to pay for imported goods and services, foreign travel, and foreign investment.

foreign-exchange market A market where foreign currencies are traded, and the daily or spot and future prices of currencies are decided. It is on the foreign-exchange market that companies buy and sell the currencies that they need for trade and investment or have earned for trade and investment. It is also the market in which a central bank intervenes to defend its country's exchange rate, by buying or selling its own currency or the currencies of others, and thus affecting supply and demand.

foreign-exchange reserves Currencies and liquid assets held by a country that can be used to settle its international balance of payments or to intervene in foreign-exchange markets to defend its exchange rate. In Canada's case, foreign-exchange reserves consist mainly of U.S. dollars and U.S. treasury bills, gold, and Special Drawing Rights.

foreign investment The purchase by non-residents of business enterprises, mineral deposits or rights, timber or fishing licences, buildings, land, shares, bonds, futures contracts, certificates of deposit, short-term money-market instruments, bank deposits, or other assets capable of yielding a return. Foreign investment is classified as short-term or long-term, and as debt investment (investment in financial assets) or equity investment (investment in the ownership of physical assets). Equity investment, in turn, may consist of portfolio investment in shares and bonds for capital gain, interest and dividends, or direct investment in shares or productive assets to own or operate a business.

free trade International trade that takes place without the imposition of any tariffs or other barriers to the free movement of goods and services, such as quotas, government procurement rules, or import or export licences.

free-trade area An agreement between two or more countries to abolish tariff and non-tariff barriers on some or all goods and services moving between them.

fourth world The poorest of the less-developed countries, with the lowest per capita incomes, few prospects for economic growth without massive outside assistance, and few if any natural resources. Countries in this group include most of those in central Africa, India, Pakistan, and Bangladesh, and have per capita gross national products of two hundred dollars or less.

General Agreement on Tariffs and Trade (GATT) An international agreement whose objectives include the gradual reduction of trade barriers, and which sets out international rules on trade practices that all its signatories are pledged to respect.

generalized system of preferences A system of preferential or lower tariffs for less-developed countries, adopted by the General Agreement on Tariffs and Trade in 1971 to help stimulate the economic growth of developing countries.

government procurement Purchases by government of goods and services, including goods and services for its own use. Some policy-makers argue that government procurement should be used as a tool of industrial strategy, by giving a preference to domestic firms and thus assuring them of a market if they develop new technologies or products. Others argue that there is a limit to such a policy, because other countries would retaliate and because it can be considered a non-tariff barrier.

gross domestic product (GDP) The value of production of goods and services in the economy resulting from the factors of production, in particular from capital, whether of Canadians or of non-residents.

gross national expenditure (GNE) The total level of demand in the economy for goods and services; it shows how the gross national product, the total output of goods and services, is consumed through consumer spending, investment, and government spending.

gross national product (GNP) A nation's total output of goods and services, expressed either in current dollar value or, by adjusting for inflation, in real terms or by changes in physical volume. The change in the gross national product each year is the growth rate of the economy.

imports Goods and services that are consumed in one country — say, Canada — but produced in other countries.

infant industry A new and underdeveloped industry that is said to be capable of establishing itself and becoming competitive if it is given the chance to develop economies of scale and its own technology.

inflation A persistent rise in the price of goods, services, and factors of production over an extended period of time.

interdependence The mutual dependence that exists among individuals, communities, and regions of a country or among different countries in the world. No nation makes everything its consumers consume; indeed, with increasing specialization, nations are becoming even more dependent on one another.

interest The price paid by a borrower for the temporary use of someone else's money or, conversely, the price charged by a lender for the temporary use by someone else of this money. It is expressed as a per cent of the amount borrowed or lent; this is the rate of interest.

international indebtedness The amount of money that countries owe to foreign lenders, in particular to foreign governments, international agencies, foreign banks and foreign corporations.

International Monetary Fund (IMF) A specialized United Nations agency, created to maintain and enforce a world monetary system, that facilitates the expansion of international trade and investment and thus helps to raise world living standards.

interprovincial trade Trade that crosses provincial boundaries and thus falls under federal regulation.

interprovincial trade barriers Provincial laws or policies restricting the movement of goods or services from one province to another.

investment 1. As used in economics, spending on capital goods such as factories, mines, and machinery, so as to increase the productive capacity of the economy. 2. In its broader meaning, investment is any purchase of an asset to increase future income.

invisibles The non-merchandise part of a country's current account in its balance of payments. It includes the wide range of payments and receipts for all kinds of services, including interest and dividends, travel, patent and royalty payments, management and other fees between subsidiaries and head offices, insurance and banking services, transportation including shipping, various gifts, and the funds immigrants bring to a country or remit to their homelands.

joint venture A specific project carried out by two or more firms. It is sometimes an alternative to complete foreign control of a firm; a joint venture may be possible between Canadian investors and a foreign firm that has expertise in a particular new technology, for example. Joint ventures are often undertaken if one firm is too small to carry out a project by itself or if the various partners have complementary skills or technologies.

less-developed country (LDC) A term that is applied to more than one hundred countries at varying stages of economic development, all of which have a relatively low real per capita income, a low rate of domestic savings, a large part of the population engaged in agriculture, a low level of industrialization, inadequate infrastructure, large segments of the population living near the subsistence level, a dependence on foreign capital and development assistance, and considerable disguised unemployment.

market 1. The place where buyers and sellers meet to exchange goods for money or for other goods, at a price that is arrived at through an implied auction in which buyers and sellers negotiate price. A market need not be in one place; it can be world-wide. 2. The demand, actual or potential, for a product or service.

money A medium of exchange for goods and services.

monetary policy The money-supply and credit policies of the Bank of Canada, which determine the availability and cost of credit in the economy. Monetary policy is also influenced by other developments, such as changes in the balance of payments and the exchange rate.

most-favoured nation (MFN) A clause in trade agreements, in particular in the General Agreement on Tariffs and Trade, which ensures that, when one country grants a trade concession to another, the same concession is available to its other trading partners as well.

multilateralism The negotiation of trade, investment, and other international agreements that apply to virtually all countries.

multinational corporation A corporation that has subsidiaries in more than one other country, and that operates from an international or global perspective. The subsidiaries are sometimes called branch plants.

National Policy The nation-building policies of the Canadian government following Confederation in 1867. The three principal elements of the National Policy were: 1. The construction of the Canadian Pacific Railway. 2. Mass settlement of the prairies. 3. The Protective Tariff of 1879, introduced after the depression of 1873–79, to foster the growth of the Canadian manufacturing industry and, by discouraging imports from the United States, to encourage east-west trade in Canada.

new international economic order (NIEO) Proposals by the less-developed countries for a substantial change in their economic relations with the industrialized world, including Canada.

newly industrialized countries (NICs) A term describing less-developed countries in the process of rapid industrialization but whose per capita income is still too low to include them among the developed countries. NICs include Brazil, Greece, Hong Kong, Mexico, Portugal, Singapore, Spain, Taiwan and Yugoslavia.

non-tariff barrier (NTB) A government policy designed to discourage or block imports. As tariff rates have declined in importance, non-tariff barriers have become a more important protectionist device.

North-South dialogue The ongoing discussions between the rich, industrialized nations of the northern hemisphere, including Canada, and the poor, less-developed countries of the southern hemisphere, over a new international economic order.

opportunity cost A term that describes the benefits sacrificed by taking one course of action instead of another. Opportunity cost is an important concept in making investment choices and allocating resources.

Organization for Economic Co-operation and Development (OECD) An organization of industrial nations, with a permanent staff of officials, established in 1961 to improve trade and investment flows among its members, to help analyze and deal with balance-of-payments and other economic problems, and to co-ordinate foreign-aid policies.

Ottawa Agreements A series of trade agreements made among Britain and the members of the British Commonwealth at the Imperial Economic Conference held in Ottawa in 1932. The agreements, consisting of twelve bilateral treaties, raised tariffs against the rest of the world and established lower, preferential-tariff rates among members of the Commonwealth.

Pacific Rim A term used to describe the region which encompasses the countries of Japan, Thailand, Singapore, Malaysia, the Phillipines, Indonesia, Hong Kong, Taiwan, and South Korea. Most classifications also include Australia and New Zealand, as well as the People's Republic of China (PRC). Because of divergent cultures in the region and PRC ''superpower'' status, the term sometimes excludes the latter countries.

portfolio investment The purchase of shares and bonds for the income they yield or the capital gains they may bring; such investment is not made for the purpose of acquiring control of a company.

primary industry An industry that produces the raw materials employed in an economy.

productivity The output of goods and services in the economy or in an industry from the effective use of various inputs, such as skilled workers, capital equipment, managerial know-how, technological innovation, and entrepreneurial activity, used to produce those goods and services.

profit What is left over for the owners of a business after all expenses have been deducted from the revenues of the firm.

protectionism Policies to restrict trade, such as high tariffs, quotas, import licences, and a wide variety of non-tariff barriers, such as government purchasing policies, health standards, and artificial import valuations. The purpose of all of these measures is to keep out imports and to protect local industries and jobs.

quota A limitation: for example, on the volume of imports, exports.

rationalization In industrial policy, the reorganization of firms in an industry — through mergers, for example — to achieve economies of scale in production, and sufficient size and cash-flow to support research and development and similar essential corporate activities.

reciprocity The exchange of tariff reductions and other trade concessions by one nation, in exchange for similar concessions from another.

reserve currency A national currency that is widely accepted and used in financing international trade, in maintaining exchange rates in foreign-exchange markets, and in settling individual countries' balances of payments. As such, a reserve currency is held in the foreign-exchange reserves of individual nations, along with gold and Special Drawing Rights; indeed, it usually constitutes the major component of a nation's foreign-exchange reserves.

revaluation An increase in the value of a country's exchange rate.

secondary industry A synonym for manufacturing industry.

service An intangible consumer or producer good that is usually consumed at the time it is produced and purchased. Examples include banking, teaching, engineering, and computer software.

Special Drawing Rights (SDRs) A reserve asset created by the International Monetary Fund to replace the use of gold and U.S. dollars in the international monetary system. Sometimes called paper gold, SDRs were adopted as the new international reserve asset for the settlement of balance-of-payments deficits between countries. They are held in individual countries' central banks.

specialization The division of various functions or production steps in the manufacture of a particular product among different workers in the same firm, or of different goods and services among different firms, regions, or nations.

tariff A tax on imported goods, levied either as a percentage of their value or according to the number of units shipped.

tariff war An escalating competition between two or more countries, which impose increasingly harsh barriers against the entry of each other's goods as the war heats up.

terms of trade An indication of how a nation is faring in international trade. It is the ratio of the price index for merchandise exports to the price index for merchandise imports.

Third Option A foreign-economic-policy decision made by the federal government in October 1972, to reduce Canada's economic dependence on the United States.

third world Those nations that see themselves as members of neither the developed Western or capitalist world, nor the developed Eastern or communist world of the Soviet Union and its satellites.

tied aid Foreign aid to less-developed countries that attaches conditions to the way in which the loan or grant is to be spent.

trade The exchange of goods and services for money. Foreign trade consists of exchanges of goods and services for money between Canadians and non-residents.

trade barrier Any government policy that restricts the free movement of goods and services between countries. The best-known barriers are tariffs and quotas. But there are many non-tariff barriers to trade as well.

trade bloc A group of two or more countries that agree to increase trade among themselves through reciprocal trade preferences, which they do not grant to countries outside their bloc. A trade bloc can take the form of a common market or a customs union.

trade deficit The situation that exists when the dollar or money value of a country's merchandise imports is greater than the value of merchandise exports.

United Nations Conference on Trade and Development (UNCTAD) A United Nations organization established in December 1964 to promote the economic interests of the less-developed countries.

value of the Canadian dollar The exchange rate of the Canadian dollar, expressed in terms of a key international currency.

visibles Merchandise exports and imports; as opposed to invisibles, such as interest, dividend, and travel payments. Both visible and invisible items of trade are considered in the current account of a country's balance of payments. The visible balance of trade is simply another name for the balance of trade in tangible goods.

world product mandate A Canadian subsidiary is responsible for the production of a limited range of parent company product lines for the world market. It rationalizes international operations and lets a company attain the economies of scale necessary to be globally competitive.

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